

STUDY MATERIAL  
EXECUTIVE PROGRAMME

**ECONOMIC, BUSINESS AND  
COMMERCIAL LAWS**

**MODULE 2  
PAPER 7**



**THE INSTITUTE OF  
Company Secretaries of India**  
**भारतीय कम्पनी सचिव संस्थान**  
**IN PURSUIT OF PROFESSIONAL EXCELLENCE**  
Statutory body under an Act of Parliament  
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# **EXECUTIVE PROGRAMME**

## **ECONOMIC, BUSINESS AND COMMERCIAL LAWS**

India redrafted its economic policy to usher in a new era of deregulation, liberalisation and global integration. Since then significant policy initiatives have been introduced, to provide stimulus for accelerated growth, industrial efficiency and international competitiveness. As part of reform process, the Government has also initiated legislative reforms in the area of Economic, Business and Commercial laws. The Government enacted Foreign Exchange Management Act, The Competition Act, 2002, Consumer Protection Act, 2019, Real Estate (Regulation and Development) Act, 2016 and amended Benami Transaction Prohibitions Act. Further, the Prevention of Money Laundering Act to deal with new categories of economic offences, has also been enacted. Similarly, in the area of consumer protection and business laws, the process of reforms is going on.

In the light of above developments, this study material has been prepared to provide an understanding of certain Economic, Business and Commercial legislations which have direct bearing on the functioning of companies. The study material has been divided into three parts consisting of twenty four study lessons. Part I dealing with Foreign Exchange Management & NBFCs consists of Study Lessons I to XI, whereas Part II dealing with Competition Laws consists of Study Lesson XII and Part III dealing with Business & Commercial Laws consists of Study Lessons XIII to XXIV.

This study material has been published to aid the students in preparing for the Economic, Business and Commercial Laws paper of the CS Executive Programme. It has been prepared to provide basic understanding of some of the Economic, Business and Commercial laws thereunder, which have a bearing on the conduct of corporate affairs. It is part of the educational kit and takes the students step by step through each phase of preparation stressing key concepts, principle, pointers and procedures. Company Secretaryship being a professional course, the examination standards are set very high, with emphasis on knowledge of concepts, applications, procedures and case laws, for which sole reliance on the contents of this study material may not be enough. Besides, as per the Company Secretaries Regulations, 1982, students are expected to be conversant with the amendments to the laws made upto six months preceding the date of examination. The material may, therefore, be regarded as the basic material and must be read alongwith the original Bare Acts, Rules, Regulations, Case Law, Chartered Secretary Journal published by the Institute every month. The legislative changes made upto July, 2021 have been incorporated in the study material

The subject of Economic, Business and Commercial Laws is inherently complicated and is subjected to constant refinement through new primary legislations, rules and regulations made thereunder and court decisions on specific legal issues. It, therefore becomes necessary for every student to constantly update himself with the various legislative changes made as well as judicial pronouncements rendered from time to time by referring to the Institute's journal 'Chartered Secretary' and e-bulletin as well as other law/professional journals.

In the event of any doubt, students may write to the Directorate of Professional Development, Perspective Planning & Studies of the Institute for clarification at [academics@icsi.edu](mailto:academics@icsi.edu).

Although care has been taken in publishing this study material yet the possibility of errors, omissions and/or discrepancies cannot be ruled out. This publication is released with an understanding that the Institute shall not be responsible for any errors, omissions and/or discrepancies or any action taken in that behalf.

Should there be any discrepancy, error or omission noted in the study material, the Institute shall be obliged if the same is brought to its notice for issue of corrigendum in the e-bulletin.

**EXECUTIVE PROGRAMME**  
**Module 2**  
**Paper 7**  
**ECONOMIC, BUSINESS AND COMMERCIAL LAWS**  
**(Max Marks 100)**

**Objective:**

Part I: To provide expert knowledge in Foreign Exchange Management and NBFCs. Part II : To provide expert knowledge in Competition Law.

Part II: To provide working knowledge in Business and Commercial Laws.

**SYLLABUS**

**Part I: Foreign Exchange Management &NBFCs (40 Marks) Detailed Contents**

1. **Reserve Bank of India Act, 1934:** Central Banking functions; Monetary policy; Penalties.
2. **Foreign Exchange Management Act, 1999:** Introduction
3. **Foreign Exchange Transactions & Compliances:** Current and Capital Account Transactions; Acquisition & Transfer of Immovable Property in India and Abroad; Realization and Repatriation of Foreign Exchange; Brief information of other FEMA Regulations.
4. **Foreign Contribution (Regulation) Act, 2010:** Introduction and Object, Eligible Contributor, Eligible Receiver, Registration, Offences and Penalties.
5. **Foreign Direct Investments - Regulations & FDI Policy:** Automatic and Approval Route of FDI; Setting up of Subsidiary/Joint Venture/Liaison Office/ Branch Office by Non-residents; Foreign Portfolio Investments.
6. **Overseas Direct Investment:** ODI Policy, foreign currency remittances, Setting up of Subsidiary/Joint Venture/Branch Office.
7. **Liberalized Remittance Scheme:** Investment Outside India by Indian Residents.
8. **External Commercial Borrowings (ECB):** An Overview.
9. **Foreign Trade Policy & Procedure:** Merchandise Exports from India Scheme (MEIS); Service Exports from India Scheme (SEIS); Duty exemption / remission schemes; Export oriented units (EOUS); Electronics Hardware Technology Parks (EHTPS); Software Technology Parks (STPS); Bio-Technology Parks (BTPS). Imports and related policies.

**10. Non-Banking Finance Companies (NBFCs):** Definition; Types; Requirement of Registration as NBFC and exemptions from registration as NBFC; Micro Finance Institutions, Activities of NBFCs; Accepting NBFCs; Deemed NBFC; Core Investment Company and Systemically Important Core Investment Companies; Peer to Peer Lending; Defaults, Adjudication, prosecutions and penalties.

**11. Special Economic Zones Act, 2005:** Establishment of Special Economic Zones; Approval and Authorization to Operate SEZ; Setting up of Unit; Special Economic Zone Authority.

### **Case Laws, Case Studies & Practical Aspects**

#### **Part II: Competition Law (25 Marks)**

**12. Competition Act, 2002:** Competition Policy ; Anti-Competitive Agreements; Abuse of Dominant Position; Overview of Combination and Regulation of Combinations; Competition Advocacy; Competition Commission of India; Appellate Tribunal.

### **Case Laws, Case Studies & Practical Aspects**

#### **Part III: Business & Commercial Laws (35 Marks)**

### **Consumer Protection**

**13. Consumer Protection Act, 1986:** Consumer Protection in India; Rights of Consumers; Consumer Dispute Redressal Forums; Nature and Scope of Remedies.

**14. Essential Commodities Act, 1955:** Essential Commodities; Powers of Central Government; Authorities responsible to administer the Act; Delegation of powers; Nature of Order passed under the Act; Seizure and Confiscation of Essential Commodities; Offences by Companies.

**15. Legal Metrology Act, 2009:** Standard weights and measures; Power of inspection, seizure; Declarations on pre-packaged commodities; Offences and penalties.

### **Property Law**

**16. Transfer of Property Act, 1882:** Types of Properties; Properties which cannot be Transferred; Rule Against Perpetuities; Lis Pendens; Provisions Relating to Sale; Mortgage, Charge, Lease, Gift and Actionable Claim; Specific Performance.

**17. Real Estate (Regulation and Development) Act, 2016:** Registration of Real Estate Project; Real Estate Agents; Real Estate Regulatory Authority; Central Advisory Council; The Real Estate Appellate Tribunal; Offences, Penalties and Adjudication. Specimen Agreement for Sale between the Promoter and the Allottee; Due Diligence Reporting.

### **Anti-Corruption Laws**

**18. Benami Transaction Prohibitions (Act):** Benami Property; Benami Transaction, Prohibition of Benami Transaction; Authority, Adjudication of Benami property.

**19. Prevention of Money Laundering:** Problem and adverse effect of money laundering; Methods of money laundering; Offence of money laundering; Attachment, adjudication and confiscation.

## **Business Laws**

20. **Indian Contracts Act, 1872:** Essential elements of a Valid Contract; Indemnity and Guarantee; Bailment and Pledge; Law of Agency; E-Contract; Landmark judgments. unenforceable contracts; Rescission of Contracts; Cancellation of Instruments; Declaratory Decrees; Preventive Reliefs.
22. **Sale of Goods Act, 1930:** Essentials of a Contract of Sale; Sale Distinguished from Agreement to Sell, Bailment, Contract for Work and Labour and Hire-Purchase; Conditions and Warranties; Doctrine of Caveat Emptor; Performance of the Contract of Sale; Landmark judgments.
23. **Partnership Act, 1932:** Rights and Liabilities of Partners; Registration of Firms; Dissolution of Firms and Partnership; Landmark judgments
24. **Negotiable Instrument Act, 1881:** Negotiable Instruments and Parties; Material Alteration; Crossing and bouncing of Cheques; Dishonour of Cheques & its Remedies; Presumption of Law as to Negotiable Instruments; Landmark judgments.

## **Case Laws, Case Studies & Practical Aspects**

# LESSON WISE SUMMARY

## ECONOMIC, BUSINESS AND COMMERCIAL LAWS

### PART I - FOREIGN EXCHANGE MANAGEMENT & NBFCs

#### Lesson 1 - Reserve Bank of India Act, 1934

The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. The purposes for which the Reserve Bank of India was established as India's central bank have been spelt out in the preamble to the Reserve Bank of India Act, which states as follows:

- (i) to regulate the issue of banknotes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage; and
- (ii) that it is essential to have a modern monetary policy framework to meet the challenge of an increasingly complex economy; the primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth and the monetary policy framework in India shall be operated by the Reserve Bank of India.

The objective of the lesson is to introduce the students regarding:

- Origins of the Reserve Bank of India;
- Banking Functions;
- Issue bank notes;
- Monetary Policy Functions;
- Public Debt Functions;
- Foreign Exchange Management;
- Banking Regulation & Supervision;
- Regulation and Supervision of NBFCs;
- Regulation & Supervision of Co-operative banks;
- Regulation of Derivatives and Money Market Instruments;
- Payment and Settlement Functions;
- Consumer Protection Functions;
- Financial Inclusion and Development Functions;

#### Lesson 2 - Foreign Exchange Management Act, 1999 – Introduction

The Foreign Exchange Management Act, 1999 (FEMA) is an Act of the Parliament of India to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. The Act extends to the whole of India and it also applies to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies.

It is expected that, at the end of this lesson, students will, *inter alia*, be in a position to:

- Understand the Concept of FEMA;
- Structure and Overall Schemes of FEMA;
- Rules and Regulations framed by RBI under FEMA;

### **Lesson 3 - Foreign Exchange Transactions & Compliances**

The management of foreign exchange is very important in the present day business. FEMA is a regulatory mechanism that enables the Reserve Bank of India to pass regulations and the Central Government to pass rules relating to foreign exchange in tune with the Foreign Trade policy of India. The Act is more transparent in its application as it lays down the areas requiring specific permissions of the Reserve Bank/Government of India on acquisition/holding of foreign exchange. It stipulates the strict compliances in case of import, export, debt funding, equity capital infusion, transfer of shares etc.

The objective of the lesson is to facilitate the students to acquaint with:

- Concept of Current Account Transactions and Capital Account Transactions;
- Provisions of Realisation, Repatriation and Surrender of Foreign Currency;
- Limits for possession or retention of foreign currency or foreign coins; and
- Procedure for Adjudication, Appeal and Compounding.

### **Lesson 4 - Foreign Contribution (Regulation) Act, 2010**

Foreign Contribution (Regulation) Act, 2010 regulate the acceptance and utilisation of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the national interest and for matters connected therewith or incidental thereto. The Act mandates that every bank or authorized person in foreign exchange shall report to specified authority, the prescribed amount of foreign remittance, source and manner in which foreign remittance was received and other particulars.

It is expected that, at the end of this lesson, students will, *inter alia*, be in a position to:

- Regulation of foreign contribution, foreign Source and foreign hospitality;
- Accounts, Intimation, Audit and Disposal of Assets; and
- Inspection, Search and Seizure.

### **Lesson 5 - Foreign Direct Investment – Regulation & Policy**

Foreign Direct Investment (FDI) is a major source of non-debt financial resource for the economic development of India. Foreign companies invest in India to take advantage of relatively lower wages, special investment privileges such as tax exemptions, etc. To promote Foreign Direct Investment (FDI), the Government has put in place an investor friendly policy, wherein except for a small negative list, most sectors are open for 100% FDI under the Automatic route.

The objective of the lesson is to familiarize the students with:

- Eligible Investors under FDI;
- Entry Routes for Investment i.e. Automatic Route, Government Route, Competent authority etc;
- Instruments for Investments i.e. equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares etc;

- Prohibited and Permitted Sectors;
- Conditions of FDI in major sector i.e. E-commerce activity, Insurance etc.;
- Conversion of ECB/lump sum fee/royalty etc. into Equity;
- Provisions of FDI with respect to Issue of Rights/Bonus Shares& Employees Stock Option Scheme (ESOPS)/Sweat Equity;
- Acquisition of Shares under Scheme of Merger/Demerger/Amalgamation;
- Modes of Payment allowed for receiving FDI in an Indian Company;
- Reporting of FDI i.e. Reporting of Inflow/Issue of shares/Transfer of shares etc; and
- Conditions and procedure for establishment of branch office (BO)/ liaison office (LO)/ project Office (PO) in India.

### **Lesson 6 - Overseas Direct Investments (ODI)**

Overseas Direct Investments (ODI) refers to the investments made in the overseas entities by way of contribution to their capital or subscription to the Memorandum of Association of a foreign entity or by way of purchase of existing shares of a foreign entity either by market purchase or private placement or through stock exchange, but it does not include portfolio investment.

Overseas investments (or financial commitment) in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global business by Indian entrepreneurs. The purpose of the lesson is to familiarize the students with:

- Two way approach to the approval of direct investment, i.e. Automatic Route and Approval Route;
- Proposal for making ODI under approval route and Prior RBI approval;
- Financial Commitment;
- Eligibility to make ODI under the Automatic Route;
- Permissible Sources for Funding Overseas Direct Investment;
- Acquisition/Sale of Foreign Securities by Resident Individual in India; and
- Obligations of Indian party which has made direct investment outside India etc.

### **Lesson 7 - Liberalized Remittance Scheme (LRS)**

Liberalised Remittance Scheme was introduced on February 4, 2004 as a liberalization measure to facilitate resident individuals to remit funds abroad for permitted current or capital account transactions or combination of both. The Scheme is available to all resident individuals including minors and not available to corporates, partnership firms, HUF and trusts.

This lesson is designed to familiarize the students with:

- Overview of Liberalised Remittance Scheme;
- Permissible Capital Account Transactions and Current Account Transactions by an individual under LRS; and
- Remittance facilities to Persons other than Individuals.

## **Lesson 8 - External Commercial Borrowings (ECB)**

External Commercial Borrowings are commercial loans raised by eligible resident entities from recognised non- resident entities and should conform to parameters such as minimum maturity, permitted and non- permitted end-uses, maximum all-in-cost ceiling, etc. Transactions on account of External Commercial Borrowings (ECB) are governed by clause (d) of sub-section 3 of section 6 of the Foreign Exchange Management Act, 1999 (FEMA).However, ECB framework is not applicable in respect of investment in Non-convertible Debentures (NCDs) in India made by Registered Foreign Portfolio Investors (RFPIs).

The objective of the lesson is to familiarize the students with:

- Overview of ECB, Tracks of ECB i.e. Track I, Track II & Track III and kinds of ECB;
- Routes available for raising ECB;
- Provisions of Conversion of ECB into equity;
- Procedure for raising ECB; and
- Reporting Requirements i.e. In case of Changes in terms and conditions of ECB, Conversion of ECB into equity etc.

## **Lesson 9 - Foreign Trade Policy and Procedure**

The Foreign Trade Policy, 2015-20, is notified by Central Government seeks to provide astable and sustainable policy environment for foreign trade in merchandise and services.India's Foreign Trade Policy (FTP) has, conventionally, been formulated for five years at a time and reviewed annually. The focus of the FTP has been to provide a framework of rules and procedures for exports and imports and a set of incentives for promoting exports.

The objective of the lesson is to facilitate the students to acquaint with:

- Provisions regarding Imports and Exports;
- Importer-Exporter Code (IEC) Number/E-IEC;
- Required Documents for Export/Import of Goods From/into India;
- Merchandise Exports from India Scheme (MEIS);
- Service Exports from India Scheme (SEIS);
- Duty exemption / remission schemes;
- Export oriented units (EOUS);
- Electronics Hardware Technology Parks (EHTPS);
- Software Technology Parks (STPS);
- Bio-Technology Parks (BTPS); and
- Imports and related policies.

## **Lesson 10 - Non-Banking Finance Companies (NBFCs)**

India has financial institutions which are not banks but which accept deposits and extend credit like banks. These are called Non-Banking Financial Companies (NBFCs) in India. The regulation and supervision of non-banking financial companies is one of the critical functions that the Reserve Bank of India (RBI) has been entrusted with. Reserve Bank of India(RBI) Act mandates every non-banking financial company to obtain a certificate of registration from RBI and to maintain net owned fund as may be specified by RBI in the Official Gazette,

before commencing such non-banking financial business. Further, as part of regulation and supervision of non-banking financial companies, RBI has been conferred with the statutory powers to regulate or prohibit issue of prospectus or advertisements soliciting deposits of money by non-banking financial companies, power to determine policy and issue directions to non-banking financial companies.

The objective of the lesson is to introduce the students regarding:

- Types of NBFC;
- Activities of NBFCs;
- Compliances by the NBFCs;
- Deposit Accepting and Non-deposit Accepting NBFCs;
- Core Investment Company;
- Systemically Important Core Investment Companies; and
- Peer to Peer Lending.

### **Lesson 11 - Special Economic Zones Act, 2005**

Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs. Goods and services going into the SEZ area from Domestic Tariff Area treated as exports and goods coming from the SEZ area into DTA treated as if these are being imported.

Special Economic Zone Act, 2005 to provide for the establishment, development and management of the Special Economic Zones for the promotion of exports and for matters connected therewith or incidental thereto. SEZ Rules, 2006 authorises company secretaries to appear before Board of Approval constituted under Section 8 of the Act.

The purpose of this lesson is to provide the students with:

- Establishment of Special Economic Zones;
- Approval and Authorization to Operate SEZ;
- Setting up of Unit; and
- Special Economic Zone Authority.

## **PART II- COMPETITION LAW**

### **Lesson 12-Competition Act, 2002**

Economic theory suggests that prices and quantities in a competitive market equilibrate to levels that generate efficient outcomes at a given point of time. Competition is therefore, beneficial as it provides to consumers wider choice and provides sellers with stronger incentives to minimize costs, so eliminating waste. Competition Act, 2002 to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in the markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participant in the markets in India and for matters connected therewith or incidental thereto. Competition Act, 2002, authorizes a company secretary holding a certificate of practice to appear before Competition Commission of India.

The objective of the lesson is to introduce the students regarding:

- Competition Policy;
- Anti-Competitive Agreements;
- Abuse of Dominant Position;
- Overview of Combination and Regulation of Combinations;
- Competition Advocacy;
- Competition Commission of India; and
- Right to legal representation.

### **PART III - BUSINESS & COMMERCIAL LAWS**

#### **CONSUMER PROTECTION**

##### **Lesson 13- Consumer Protection Act, 2019**

The Consumer Protection Act, 1986 was enacted to provide for better protection of the interests of consumers and for the purpose of making provision for establishment of consumer protection councils and other authorities for the settlement of consumer disputes, etc. Consumer markets for goods and services have undergone drastic transformation, therefore, Parliament enacted the Consumer Protection Act, 2019.

The objective of the lesson is to introduce the students regarding:

- Consumer Protection in India;
- Rights of Consumers;
- Consumer Dispute Redressal Forums;
- Nature and Scope of Remedies; and
- E-Commerce.

##### **Lesson 14 - Essential Commodities Act, 1955**

The Preamble to the Act says that it is an Act to provide in the interest of the general public for the control of the production, supply and distribution of, and trade and commerce in, certain commodities. The dominant object and intendment of the Act is to secure equitable distribution and availability at fair prices of essential commodities in the interest of the general public. The interest of the general public necessarily connotes the interest of the consuming public and not the interest of the dealer.

Necessary powers have been given to the Central Government under the Act to administer the provisions of the Act by issuing orders/directions notified in the official gazette and by delegating the authority to State Governments and administrators of Union Territories. The Central Government at its apex level is responsible for achieving the objectives enshrined by the Parliament under this Act for the welfare and general well-being of all the citizens.

The purpose of this lesson is to provide the students with:

- Essential Commodities;
- Powers of Central Government;
- Authorities responsible to administer the Act;
- Seizure and Confiscation of Essential Commodities; and
- Offences by Companies.

## **Lesson 15 - Legal Metrology Act, 2009**

The branch of knowledge concerning weights and measures is technically known as legal metrology. In basic form, metrology is the science of measurement. Legal metrology Act, 2009 intend to establish and enforce standards of weights and measures, regulate trade and commerce in weights, measures and other goods which are sold or distributed by weight, measure or number and for matters connected therewith or incidental thereto.

The objective of the lesson is to introduce the students regarding:

- Standard weights and measures;
- Power of inspection, seizure;
- Declarations on pre-packaged commodities; and
- Offences and penalties.

## **PROPERTY LAW**

### **Lesson 16 - Transfer of Property Act, 1882**

Property has, always, been on the fundamental elements of socio economic life of an individual. Transfer of Property means an act by which a living person conveys property in present, or in future, to one or more other living persons, or to himself and one or more other living persons and “to transfer property” is to perform such an act. Consequently, the law relating to transfer of property is not only an important branch of civil law but also one that demands proper elucidation due to its complexity.

It is expected that, at the end of this lesson, students will, *inter alia*, be in a position to:

- Understand types of Properties;
- Know Rules relating to Transfer of Property;
- Properties which cannot be transferred;
- Lis Pendens; and
- Understand Provisions Relating to Sale; Mortgage, Charge, Lease.

### **Lesson 17 - Real Estate (Regulation and Development) Act, 2016**

Parliament enacted the Real Estate (Regulation and Development) Act, 2016 which aims at protecting the rights and interests of consumers and promotion of uniformity and standardization of business practices and transactions in the real estate sector. It attempts to balance the interests of consumers and promoters by imposing certain responsibilities on both. It seeks to establish symmetry of information between the promoter and purchaser, transparency of contractual conditions, set minimum standards of accountability and a fast-track dispute resolution mechanism.

As per Section 56 of the Act, the applicant or appellant may either appear in person or authorise one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Appellate Tribunal or the Regulatory Authority or the adjudicating officer, as the case may be.

The objective of the lesson is to introduce the students regarding:

- Registration of Real Estate Project;
- Real Estate Agents;
- Real Estate Regulatory Authority;

- The Real Estate Appellate Tribunal; and
- Specimen Agreement for Sale between the Promoter and the Allottee; Due Diligence Reporting.

## ANTI-CORRUPTION LAWS

### Lesson 18 - Benami Transaction Prohibitions (Act)

Benami Transactions (Prohibition) Act, 1988 defines benami transaction and benami property and also provides for exclusions and transactions which shall not be construed benami. The legislation is also intended to effectively prohibit benami transactions and consequently prevent circumvention of law through unfair practices. It empowers the Government to confiscate benami property by following due procedure. It therefore promotes equity across all citizens.

The purpose of this lesson is to provide the students with:

- Benami Property;
- Benami Transaction;
- Prohibition of Benami Transaction; and
- Adjudication of Benami property.

### Lesson 19 - Prevention of Money Laundering

The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. Organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments. The economic and political influence of criminal organisations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society. In countries transitioning to democratic systems, this criminal influence can undermine the transition. Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue.

The Prevention of Money-laundering Act, 2002 enacted to prevent money laundering and to provide for confiscation of property derived from, or involved in, money laundering and for matters connected therewith or incidental thereto.

The objective of the lesson is to introduce the students regarding:

- Problem and adverse effect of money laundering;
- Methods of money laundering;
- Offence of money laundering; and
- Attachment, adjudication and confiscation.

## BUSINESS LAWS

### Lesson 20 - Indian Contracts Act, 1872

The Law of Contract constitutes the most important branch of Mercantile or Commercial Law. It affects everybody, more so, trade, commerce and industry. It may be said that the contract is the foundation of the modern world. The Indian Contract Act, 1872 regulates all the transactions of a company.

- It lays down the general principles relating to the formation and enforceability of contracts; rules governing the provisions of an agreement and offer;

- Various types of contracts including those of indemnity and guarantee, bailment and pledge and agency; and
- It also contains provisions pertaining to breach of a contract.

### **Lesson 21 - Specific Relief Act, 1963**

The Specific Relief Act, 1963 was enacted to define and amend the law relating to certain kinds of specific relief. It contains provisions, *inter alia*, specific performance of contracts, contracts not specifically enforceable, parties who may obtain and against whom specific performance may be obtained, etc. It also confers wide discretionary powers upon the courts to decree specific performance and to refuse injunction, etc.

It is expected that, at the end of this lesson, students will, *inter alia*, be in a position to:

- Understand specific reliefs and defense;
- Specific performance and defense;
- Unenforceable contracts; and
- Know Decrees and Preventive Reliefs.

### **Lesson 22-Sale of Goods Act, 1930**

The law relating to sale of goods is contained in the Sale of Goods Act, 1930. In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfillment of some conditions subject to which the property in the goods is to be transferred.

The purpose of this lesson is to provide the students with:

- Essentials of a Contract of Sale;
- Sale Distinguished from Agreement to Sell;
- Bailment;
- Conditions and Warranties; and
- Doctrine of Caveat Emptor.

### **Lesson 23 - Partnership Act, 1932**

“Partnership” is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. Persons who have entered into partnership with one another are called individually, “partners” and collectively “a firm”, and the name under which their business is carried on is called the “firm-name”. In determining whether a group of persons is or is not a firm, or whether a person is or is not a partner in a firm, regard shall be had to the real relation between the parties, as shown by all relevant facts taken together.

It is expected that, at the end of this lesson, students will, *inter alia*, be in a position to:

- Understand Rights and Liabilities of Partners;
- Registration of Firms;
- Admission of new partners; and
- Dissolution of Firms and Partnership.

## Lesson 24 - Negotiable Instrument Act, 1881

A negotiable instrument may be defined as an instrument, the property in which is acquired by anyone who takes it bona fide, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument.

The objective of the lesson is to introduce the students regarding:

- Negotiable Instruments and Parties;
- Effect of Negotiability;
- Crossing and bouncing of Cheques;
- Dishonour of Cheques & its Remedies; and
- Presumption of Law as to Negotiable Instruments.

## LIST OF RECOMMENDED BOOKS

### Paper 7: ECONOMIC, BUSINESS AND COMMERCIAL LAWS

1. Snow White: Foreign Exchange Management Manual.
2. Statutory Manual
3. Statutory Guide for NBFCs with Law Relating to Securitisation and Reconstruction of Financial Assets- Taxmann (2017)
4. Law & Practice Relating to Special Economic Zones- Taxmann Publications Private Limited
5. T. Ramappa: Competition Law in India – Policies, Issues, and Developments; Oxford University Press, New Delhi.
6. Guide to Competition Law- Containing Commentary on the Competition Act, 2002; MRTP Act, 1969 & the Consumer Protection Act, 1986 (Set of 2 Volumes)- S.M.Dugar, revised by Arijit Pasayat, Sudhansu Kumar (2016)
7. S M Dugar's Guide to Competition Act, 2002- Author : S.M.Dugar, revised by Sudhansu Kumarwith a foreword by Dhanendra Kumar (2018)
8. Consumer Protection Law and Practice- Dr. V.K. Aggarwal
9. Consumer Protection Act, 2019 - Bare Act
10. Essential Commodities Act, 1955 (Act No. 10 of 1955) (Lawmann's) (2017)- Lawmann
11. The Legal Metrology Act, 2009- Virag Gupta & Gaurav Pathak (2018)
12. The Transfer of Property Act, 1882 with Exhaustive Case Law- Universal's Concise Commentary (2017)
13. Real Estate (Regulation and Development) Act 2016 - Taxmann (2017)
14. Prohibition of Benami Property Transactions Act 1988 (Bare Act) (August 2016 Edition)- Taxmann
15. Law on Prevention of Money Laundering in India (2017)- M C Mehanathan
16. The Indian Contract & Specific Relief Acts (Set of 2 Volumes) (2017)- Pollock and Sir Dinshaw Fardunji Mulla
17. Sale of Goods Act, 1930 (Lawmann's)(2017)- Lawmann
18. Indian Partnership Act, 1932 (Lawmann's) (2017)- Lawmann
19. The Negotiable Instruments Act (2016)- Universal Law Series

### Journals:

1. e-Bulletin 'Student Company Secretary' : The ICSI, New Delhi-110 003.
2. Chartered Secretary (Monthly) : The ICSI, New Delhi-110 003.
3. All India Reporter : All India Reporter Ltd., Congress Nagar, Nagpur.

### Note:

1. Students are advised to read the above journals for updating the knowledge.
2. Students are advised to read/refer the latest editions of the recommended books.

# ARRANGEMENT OF STUDY LESSONS

## Module-2 Paper 7 ECONOMIC, BUSINESS AND COMMERCIAL LAWS

| Sl. No.  | Lesson Title  |
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| <b>Part I: Foreign Exchange Management and NBFCs</b>   |   |
| 1.   | Reserve Bank of India Act, 1934                       |
| 2.   | Foreign Exchange Management Act, 1999                 |
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| 4.   | Foreign Contribution (Regulation) Act, 2010           |
| 5.   | Foreign Direct Investments – Regulations & FDI Policy |
| 6.   | Overseas Direct Investment                            |
| 7.   | Liberalized Remittance Scheme                         |
| 8.   | External Commercial Borrowings (ECB)                  |
| 9.   | Foreign Trade Policy & Procedure                      |
| 10.  | Non-Banking Finance Companies (NBFCs)                 |
| 11.  | Special Economic Zones Act, 2005                      |
| <b>Case Laws, Case Studies &amp; Practical Aspects</b> |   |
| <b>Part II : Competition Law</b>                       |   |
| 12.  | Competition Act, 2002                                 |
| <b>Part III : Business &amp; Commercial Laws</b>       |   |
| <b>Consumer Protection</b>                             |   |
| 13.  | Consumer Protection Act, 1986:                        |
| 14.  | Essential Commodities Act, 1955                       |
| 15.  | Legal Metrology Act, 2009                             |
| <b>Property Law</b>                                    |   |
| 16.  | Transfer of Property Act, 1882                        |
| 17.  | Real Estate (Regulation and Development) Act, 2016    |
| <b>Anti-Corruption Laws</b>                            |   |
| 18.  | Benami Transaction Prohibitions (Act)                 |
| 19.  | Prevention of Money Laundering                        |
| <b>Business Laws</b>                                   |   |
| 20.  | Indian Contracts Act, 1872                            |
| 21.  | Specific Relief Act, 1963                             |
| 22.  | Sale of Goods Act, 1930                               |
| 23.  | Partnership Act, 1932                                 |
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# Reserve Bank of India Act, 1934

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## ***Key Concepts One Should Know***

- Reserve Bank of India
- Governor and Deputy Governor of RBI
- Monetary Policy Framework
- Instruments of Monetary Policy

## ***Learning Objectives***

### **To understand:**

- Origins of the Reserve Bank of India
- Functions of the Reserve Bank
- Banking Functions
- Issue bank Notes
- Monetary Policy Function
- Public Debt Functions
- Foreign Exchange Management
- Banking Regulation & Supervision
- Regulation and Supervision of NBFCs
- Regulation & Supervision of Co-operative Banks
- Regulation of Derivatives and Money Market Instruments
- Payment and Settlement Functions;
- Monetary Policy

## ***Regulatory Framework***

- Reserve Bank of India Act, 1934

## ***Lesson Outline***

- Origins of the Reserve Bank of India
- Organisational Structure & Management
- Reserve Bank as Banker to Banks
- Foreign Exchange Reserves Management
- Monetary policy
- Instruments of Monetary Policy
- Inflation Target
- Monetary Policy Report
- Penalty
- LESSON ROUND-UP
- GLOSSARY
- TEST YOURSELF
- LIST OF FURTHER READINGS
- OTHER REFERENCES

## INTRODUCTION

The origin of the Reserve Bank of India can be traced back to the year 1926, when the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission – recommended the creation of a central bank for India to separate the function of control of currency and credit from the Government and to augment banking facilities throughout the country. The Reserve Bank of India Act, 1934 established the Reserve Bank and set in motion a series of reform culminating in the start of its operations in the year 1935. Since then, the Reserve Bank's role and functions have undergone numerous changes, with the change in the nature of Indian economy and financial sector.

Starting as a private shareholders' bank, the Reserve Bank was nationalized in 1949, in line with demands of Independent India and the international practices prevalent in other nations. It then assumed the responsibility to meet the aspirations of a newly independent country and its people. The Reserve Bank's nationalisation aimed at achieving coordination between the policies of the government and those of central bank.

The Preamble to the Reserve Bank of India Act, 1934 (the Act), under which it was constituted, specifies its objective as regulation of the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India, generally to operate the currency and credit system of the country to its advantage and operation of the monetary policy framework in India.

The objectives outlined in the Preamble hold good. As evident from the multifaceted functions that the Reserve Bank performs today, its role and priorities have, changed in tandem with national priorities and global developments. Essentially, the Reserve Bank has demonstrated dynamism and flexibility to meet the requirements of an evolving economy.

A core function of the Reserve Bank in the past years has been the formulation and implementation of modern monetary policy framework to meet the challenges of an increasingly complex economy and with the objective of maintaining price stability while keeping in mind the objective of growth and ensuring adequate flow of credit to productive sectors of the economy.

The Reserve Bank designs and implements the regulatory policy framework for banking and non-banking financial institutions with the aim of providing people access to the banking system, protecting depositors' interest, and maintaining overall health of the financial system. Its function of regulating the commercial banking sector, which emerged with the enactment of Banking Regulation Act, 1949, has over the time, expanded to cover other entities. Thus, amendments to Banking Regulation Act, 1949 brought cooperative banks and regional rural banks under the Reserve Bank's jurisdiction, while amendments to the Reserve Bank of India Act saw development finance institutions, non-banking financial companies and primary dealers coming under its regulation, as these entities became important players in the financial system and markets.

Similarly, the global economic uncertainties during and after the Second World War warranted conservation of scarce foreign exchange reserves by sovereign intervention and allocation. Initially, the Reserve Bank carried out regulation of foreign exchange transactions under the Defence of India Rules, 1939 and later, under the Foreign Exchange Regulation Act of 1947. Over the years, as the economy matured, the role shifted from foreign exchange regulation to foreign exchange management.

Post-independence, as the emerging nation tried to meet the aspirations of a large and diversified populace, the Reserve Bank, with its experience and expertise, was entrusted with a variety of developmental roles, particularly in the field of credit delivery. With the onset of economic planning in 1950-51, the Reserve Bank undertook a variety of developmental functions to encourage savings and capital formation and widen and deepen the agricultural and industrial credit set-up. Institution building was a significant aspect of its role in the sixties and the seventies. The strategy for nearly four decades placed emphasis on the state-induced or state-supported developmental efforts. Subsequently, the role of financial sector and financial markets was also given an explicit recognition in the development strategy.

The aftermath of the economic reforms introduced in the year 1991 balance of payments and foreign exchange crisis saw a paradigm shift in India's economic and financial policies. The approach under the reform era included a thrust towards liberalisation, privatisation, globalisation and concerted efforts at strengthening the existing and

emerging institutions and market participants. The Reserve Bank adopted international best practices in areas, such as, prudential regulation, banking technology, variety of monetary policy instruments, external sector management and currency management to make the new policy framework effective.

The rapid pace of growth achieved by the financial system in deregulated regime necessitated a deepening and widening of access to banking services. The new millennium has seen the Reserve Bank play an active role in balancing the relationship between banks and customers; focusing on financial inclusion; setting up administrative machinery to handle customer grievances; pursuing clean note policy and ensuring development and oversight of secure and robust payment and settlement systems.

The last two-and-a-half decades have also seen growing integration of national economy and financial system with the globalising world. While rising global integration of Indian economy has shown its own advantages in terms of expanding the scope and scale of growth of the Indian economy, it also exposes India to global shocks. Hence, maintaining financial stability became an important mandate for the Reserve Bank. This, in turn, has brought forth the need for effective coordination and consultation with other regulators within the country and abroad.

### Origin of the Reserve Bank of India at a glance

1926: The Royal Commission on Indian Currency and Finance recommended creation of a central bank for India.

1927: A bill to give effect to the above recommendation was introduced in the Legislative Assembly, but was later withdrawn due to lack of agreement among various sections of people

1933: The White Paper on Indian Constitutional Reforms recommended the creation of a Reserve Bank. A fresh bill was introduced in the Legislative Assembly

1934: The Bill was passed and received the Governor General's assent

1935: The Reserve Bank commenced operations as India's central bank on April 1 as a private shareholders' bank with a paid up capital of rupees five crore (rupees fifty million)

1942: The Reserve Bank ceased to be the currency issuing authority of Burma (now Myanmar)

1947: The Reserve Bank stopped acting as banker to the Government of Burma

1948: The Reserve Bank stopped rendering central banking services to Pakistan

1949: The Government of India nationalised the Reserve Bank under the Reserve Bank (Transfer of Public Ownership) Act, 1948

## ESTABLISHMENT AND INCORPORATION OF RESERVE BANK

Section 3 of the RBI Act states that a bank to be called the Reserve Bank of India shall be constituted for the purposes of taking over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of the Act.

Sub-section (2) of this section further provides that the Bank shall be a body corporate by the name of Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued.

## ORGANISATIONAL STRUCTURE & MANAGEMENT

The organizational structure of RBI can be classified under the following designations:

|                                 |
|---------------------------------|
| Central Board of Directors      |
| Governor                        |
| Deputy Governor                 |
| Executive Directors             |
| Principal Chief General Manager |
| Chief General Managers          |
| General Managers                |
| Deputy General Managers         |
| Assistant General Managers      |
| Managers                        |
| Assistant Managers              |
| Support Staff                   |

## CENTRAL BOARD OF DIRECTORS

The Central Board of Directors is at the top of the Reserve Bank's organisational structure being entrusted with the general superintendence and direction of the affairs and Business of the Reserve Bank. Appointed by the Government under the provisions of Reserve Bank of India Act, 1934, the Central Board has the primary authority and responsibility for the oversight of the function of Reserve Bank. It delegates specific functions to the Local Boards and various committees.

The Central Government appoints and nominates the Directors on the Central Board of the Reserve Bank of India,

As per Section 8 of the Act, the constitution of the Central Board is as follows:

- a Governor and not more than four Deputy Governors to be appointed by the Central Government;
- four Directors to be nominated by the Central Government, one from each of the four Local Boards as constituted by section 9;
- ten Directors to be nominated by the Central Government; and

(d) two Government officials to be nominated by the Central Government;

As per Section 8 (4), the terms of the appointment or nomination of the members of the Central Board, as the case may be shall be as follows:

- i. The Governor and a Deputy Governor shall hold office for such term not exceeding five years as the Central Government may fix when appointing them and shall be eligible for re-appointment.
- i. A Director nominated under clause (c) of sub-section (1) of Section 8 shall hold office for a period of four years and shall be eligible for reappointment, provided that any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently.
- iii. A Director nominated under clause (d) of sub-section (1) of Section shall hold office during the pleasure of the Central Government

## Local Boards

The Reserve Bank also has four Local Boards, constituted by the Central Government under the RBI Act, inter alia Section 9, one each for the Western, Eastern, Northern and Southern areas of the country, which are located in Mumbai, Kolkata, New Delhi and Chennai. Each of these Boards has five members appointed by the Central Government for a term of four years and thereafter until his successor is appointed. They are eligible for re-appointment, however any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently [Section 9(3)]. The members of the Local Board shall elect from amongst themselves one person to be the Chairman of the Board. [Section 9(2)]. These Boards represent territorial and economic interests of their respective areas, and advise the Central Board on matters, such as, issues relating to local cooperative and indigenous banks. They also perform other functions that the Central Board may delegate to them. [Section 9(1)]

## Offices and Branches

The Reserve Bank has a network of offices and branches through which it discharges its responsibilities. The units operating in the four metros — Mumbai, Kolkata, Delhi and Chennai — are known as offices, while the units located at other cities and towns are called branches. Currently, the Reserve Bank has its offices, including branches, at 27 locations in India. The offices and larger branches are headed by a senior officer of the rank of Chief General Manager, designated as Regional Director while smaller branches are headed by a senior officer of the rank of General Manager.

## THE GOVERNOR AND DEPUTY GOVERNOR

The Governor is the Reserve Bank's Chief Executive. The Governor supervises and directs the affairs and business of RBI. The management team also includes Deputy Governors and Executive Directors. The Governor and Deputy Governors devote their whole time to the affairs of the Bank, and receive such salaries and allowances as may be determined by the Central Board, with the approval of the Central Government. The Deputy Governor and the Director nominated under Section 8 may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote. However when the Governor is, for any reason, unable to attend any such meeting, a Deputy Governor authorized by him in this behalf in writing may vote for him at that meeting.

The Governor and a Deputy Governor hold the office for such term not exceeding five years as the Central Government may fix when appointing them, and they are eligible for re-appointment.

## FUNCTIONS OF THE RESERVE BANK

The statutes governing the establishment and mandates of central banks play a crucial role in determining their functions across the world. The RBI has been constituted under the Reserve Bank of India (RBI Act, 1934).

The legal backing for the functions of the RBI is not only confined to the provisions of the RBI Act, but also spread over a number of statutes, such as the Banking Regulation Act, 1949, Foreign Exchange Management Act, 1999, Government Securities Act, 2006, Payment and Settlement Systems Act, 2007, etc.

The purposes for which the Reserve Bank of India established as India's Central Bank have been spelt out in the preamble to the RBI Act.

***The functions of the Reserve Bank of India can be summarized and enumerated as under:***

- Banking Functions
- Issue bank notes
- Monetary Policy Functions
- Public Debt Functions
- Foreign Exchange Management
- Banking Regulation & Supervision
- Regulation and Supervision of NBFCs
- Regulation & Supervision of Co-operative banks
- Regulation of Derivatives and Money Market Instruments
- Payment and Settlement Functions
- Consumer Protection Functions
- Financial Inclusion and Development Functions

### **Banking Functions**

The general superintendence and direction of the affairs and business of RBI is entrusted to Central Board having nominees from the Central Government and Directors appointed under Section 8 of the RBI Act. The Board of RBI is headed by the Governor and assisted by not more than four Deputy Governors.

The Board exercises all powers and does all acts and things which may be exercised by the RBI. Section 17 of the RBI Act provides for business which the RB may transact and inter-alia states that RBI may transact various businesses such as acceptance of deposits without good interest from Central Government and State Governments, purchase, sale and rediscount of Bills of Exchange, short term Loans and Advances to banks, annual Contributions to National Rural Credit Funds, dealing in Derivatives, purchase and sale of Government Securities, purchase and sale of shares of State Bank of India, National Housing Bank, Deposit Insurance and Credit Guarantee Corporation, etc., keeping of deposits with SBI for specific purposes, making and issue of Banknotes, etc.

Similarly, Section 18 facilitates the RBI to act as a 'Lender of Last Resort' permitting grant of loans and advances subject to other terms of Section 18; whereas Section 19 states the list of businesses which the RBI may not transact. This apart, the provisions of RBI Act enables the RBI to act as banker to Central Government and State Governments, being a part of Central Banking Functions. Under Sections 20 and 21 of the RBI Act, the RBI shall have an obligation and right respectively to accept monies for account of Central Government and to make payments up to the amount standing to the credit of its account, and to carry out its exchange, remittance and other banking operations, including the management of public debt of the Union. In the case of State Governments, the said banking functions may be undertaken by way of an agreement between RBI and the State Government concerned as provided in Section 21-A of RBI Act. These agreements made between the RBI and the State Governments are statutory as they are required to be laid before the Parliament as soon as they are made.

### **Issue Functions**

Right to issue bank notes is one of the key central banking functions of the RBI. Section 22 of RBI Act confers RBI with sole right to issue bank notes in India. The issue function of bank notes is performed by the Issue Department, which is separated and kept wholly distinct from Banking Department. The RBI Act enables the RBI to recommend to Central Government the denomination of bank notes, i.e. two rupees, five rupees, ten rupees, twenty rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, two thousand rupees, five thousand rupees and ten thousand rupees or other denominations not exceeding ten thousand rupees.

The design, form and material of bank notes is approved by Central Government on the recommendations of Central Board of the RBI. Every bank note is a legal tender at any place in India, however, on recommendation of the Central Board, the Central Government may declare any series of bank notes of any denomination as not to be a legal tender. Another important function is exchange of mutilated or torn notes, which under the RBI Act is not a matter of right, but a matter of grace. The bank notes that are being issued by RBI are exempt from payment of stamp duty.

### **Monetary Policy Function**

Chapter III-F of the RBI Act provides a statutory basis for Monetary Policy Framework and the Monetary Policy Committee (MPC). The Central Government, in consultation with the RBI shall determine the inflation target in terms of the Consumer Price Index, once in every five years, which needs to be notified in the Official Gazette. Similarly, it is the Central Government that should constitute a Monetary Policy Committee by notification in the Official Gazette.

The Monetary Policy Committee has been entrusted with the statutory duty to determine the Policy Rate required to achieve the inflation target. The decision of the Monetary Policy Committee is binding on RBI and the RBI is required to publish a document explaining the steps to be taken to implement the decisions of the Monetary Policy Committee. The meetings of the MPC are required to be held at least 4 times a year and its decisions to be published after each meeting.

### **Public Debt Functions**

The Parliament of India enacted the Government Securities Act, 2006 ('GS Act') with an objective to consolidate and amend the law relating to Government securities and its management by the Reserve Bank of India. Government Securities have been defined to mean a security created and issued by the Government for the purpose of raising a public loan or for any other purpose as may be notified by the Government in the Official Gazette and having one of the forms mentioned in section 3 of the GS Act, which include a Government promissory note payable to or to the order of a certain persons; a bearer bond payable to bearer; a stock; or a bond held in a bond ledger account. The GS Act accordingly applies to Government securities created and issued by the Central Government or a State Government. The GS Act prescribes the procedure and modalities to be followed by RBI in the management of public debt and also confers various powers on RBI including the power to determine the title to a Government security if there exists any doubt in the opinion of RBI. Further, Section 18 of the GS Act provides that no order made by RBI under this Act shall be called in question by any Court for the reasons stated therein.

Prior to the enactment of GS Act, the said public debt functions of the RBI were governed under the provisions of Public Debt Act, 1944. However, the enactment of the GS Act has not fully repealed the Public Debt Act, 1944. This is evident from Section 31 of the GS Act which states that the Public Debt Act, 1944, shall cease to apply to the Government securities to which this Act (GS Act) applies.

### **Foreign Exchange Management**

The powers and responsibilities with respect to external trades and payments, development and maintenance of foreign exchange market in India have been conferred on RBI under the provisions of Foreign Exchange Management Act, 1999 ('FEMA'). Section 10 of the FEMA empowers the RBI to authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or off-shore banking unit or in any other manner as it deems fit. Similarly, FEMA empowers the RBI to revoke an authorization issued to an authorized dealer in public interest, or if the authorized person has failed to comply with the conditions subject to which the authorization was granted or has contravened any of the provisions of the FEMA or any rule, regulation, notification, direction or order issued by the RBI. However, the revocation of an authorization may be done by the RBI after following the prescribed procedure in FEMA or the Regulations made thereunder. Section 13 of the FEMA details out the contraventions and penalties, and the RBI has been empowered to compound such contraventions under Section 15 of the FEMA.

### **Banking Regulation & Supervision**

The power to regulate and supervise banks has been provided to RBI under the provisions of Banking Regulation Act, 1949 (BR Act, 1949). Although, the preamble to the BR Act, 1949, states that it is an Act to consolidate and

amend the law relating to banking, the powers of RBI to formulate banking policy, regulate banking business, protect the interests of banking companies, supervision of banking companies, etc., are spread across the provisions of BR Act, 1949 and therefore the RBI has wide powers in relation thereto.

This becomes evident, firstly, from Section 5(ca) of the BR Act, 1949, which is widely worded and states that banking policy means any policy, which is specified from time to time by the RBI, in the interest of banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resources.

Secondly, as a part of RBI's regulatory power, Section 10BB of the BR Act, 1949 empowers RBI to appoint a Chairman or Managing Director of a banking company for the reasons stated therein. Similarly, as a part of control over management, Section 36-AB of BR Act, 1949, provides for power to appoint additional directors on the boards of banking companies. Not only the powers to appoint managerial persons but also the power to remove them are vested with the RBI under Section 36-AA of the BR Act, 1949. Moreover, the RBI has been empowered, to supersede the board of banking companies.

Though the business of banking is within the domain of a banking company, the power to control advances by banking companies is also provided to RBI under Section 21 of the BR Act, 1949. Similarly, Section 22 of the BR Act, 1949 confers on RBI the power to issue license and also to cancel licenses of banking companies. Another important regulatory power that has been vested with the RBI is to issue directions to banking companies. Under Section 35-A of BR Act, 1949, RBI has the power to issue directions to banking companies in the public interest or in the interest of banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of banking company or to secure the proper management of any banking company.

In this regard, it may be worthwhile to note the observations of the Hon'ble Supreme Court of India in the case of *Joseph Kuruvilla v. Reserve Bank of India* {AIR 1962 SC 1373} that in view of history of establishment of the Reserve Bank, as a Central Bank for India, its position as a banker's bank, its control over the banking companies and banking in India, its position as an issuing bank, its power to license the banking companies and cancel their licence and the numerous other powers, it is unanswerable that between the Court and the Reserve Bank, the momentous decision to wind up a tottering or unsafe banking company in the interest of the depositors, may reasonably be left to the Reserve Bank.

The provisions of the Banking Regulation (Amendment) Act, 2017, provides for dealing with cases relating to stressed assets. Stressed assets are loans where the borrower has defaulted in repayment or where the loan has been restructured, etc. In terms of Sections 35-AA and 35-AB of the BR Act, 1949, the RBI has been specifically authorized to issue directions to banking companies to initiate insolvency resolution process and in respect of stressed assets. As a part of the supervisory power, the RBI has been empowered to inspect banking companies on its own or at the instance of Central Government under the provisions of the BR Act, 1949. In so far as the regulatory and supervisory powers of the RBI over the public sector banks including the State Bank of India and the Regional Rural Banks are concerned, in addition to the provisions available in the respective Special Acts, the provisions as stated in Section 51 of the BR Act shall also be applicable. Thus an overall responsibility to find out the well-being of a banking company, in improving monetary stability and economic growth as well as keeping in view the interests of depositors, has been conferred on the Reserve Bank of India.

## Regulation and Supervision of NBFCs

The regulation and supervision of non-banking financial companies is one of the critical functions that the RBI has been entrusted with. Section 45-IA of RBI Act mandates every Non-Banking Financial Company to obtain a certificate of registration from the RBI and to maintain net owned fund as may be specified by the RBI in the Official Gazette, before commencing such non-banking financial business, with RBI having the discretion to notify different amounts of net owned fund for different categories of non-banking financial companies. Further, as part of regulation and supervision of non-banking financial companies, the RBI has been conferred with the statutory powers to regulate or prohibit issue of prospectus or advertisements soliciting deposits of money by non-banking financial companies, power to determine policy and issue directions to non-banking financial companies, cancellation of

certificate of registration granted to a non-banking financial company under certain circumstances etc. Further, the RBI has been empowered under Section 45-L of the RBI Act to call for information and issue directions to non-banking financial companies for the reasons stated therein. As a part of the supervisory control over the non-banking financial companies, the RBI has powers to inspect them under Section 45-N of RBI Act, 1934. The RBI shall exercise all these powers in the public interest or to regulate the financial system of the country to its advantage or to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of the non-banking financial company. This makes it clear that the power of RBI to regulate and supervise banking companies emanates from the provisions of BR Act whereas the powers to regulate and supervise non-banking financial companies has the source from RBI Act.

### Regulation & Supervision of Co-operative banks

Regulation and supervision of urban co-operative banks is another area the RBI has been entrusted with. In terms of Article 246 of the Constitution of India, the exercise of legislative powers of the Union and the State are given in the Union List and the State List, i.e. List I and II respectively of the VII Schedule to the Constitution. The entry relating to Cooperative Societies fall in State List whereas the entry relating to banking falls in the Union List. This results in the duality of jurisdiction over cooperative banks both by the Reserve Bank of India, in terms of Banking Regulation Act, 1949, and the Registrar of Cooperative Societies, in terms of the respective State Cooperative Societies Act, of the State concerned. Section 56 of the BR Act, 1949, makes it applicable to co-operative societies involved in the business of banking. As a part of the regulatory and supervisory regime over co-operative banks, the RBI has been entrusted with the powers to issue licenses and cancel licenses of co-operative banks, supersede their boards, inspect them and also issue directions to them in the public interest, interest of banking policy, control over loans and advances, etc. The Banking Regulation (Amendment), Act, 2020 further intends to empower RBI as far as regulation of co-operative banks is concerned

In *Janata Sahakari Bank Ltd. v. State of Maharashtra* (AIR 1993 Bombay 252) Hon'ble Bombay High Court has held that though the control over management of Co-operative Society whether it is Cooperative Banking Society or otherwise is vested in the Registrar of Co-operative Societies, but insofar as banking is concerned, by virtue of S.56 of the Banking Regulation Act, 1949, read with S.35A of the Banking Regulation Act, 1949, it will be a subject with which the Reserve Bank of India has full power.

### Regulation of Derivatives and Money Market Instruments

Chapter III-D was inserted in the RBI Act with effect from 9th January 2007 by way of an amendment to the RBI Act, 1934. In the said chapter, the Parliament of India thought it appropriate to introduce provisions relating to regulation of transactions relating to derivatives, money market instruments, securities, etc. by the RBI. Sub-section (a) of Section 45U of RBI Act defines derivative as an instrument to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called 'underlying'), or a combination of more than one of them and includes interest rate swaps, forward rate agreements, foreign currency swaps, foreign currency-rupee swaps, foreign currency options, foreign currency rupee options or such other instruments as may be specified by the RBI from time to time. Similarly, money market instruments have been defined to include call or notice money, term money, repo, reverse repo, certificate of deposit, commercial paper and such other debt instrument of original or initial maturity up to one year as the RBI may specify from time to time. Securities having been defined to mean securities of the Central Government or a State Government or such securities of a local authority as may be specified in this behalf by the Central Government. The powers of RBI to regulate securities, money market instruments, foreign exchange, derivatives, or other instruments of like nature as specified by the RBI have been provided under Section 45W of the RBI Act, which states that the RBI may specify from time to time, in public interest or to regulate the financial system of the country to its advantage, determine the policy relating to interest rates or interest rate products and give directions in that behalf to all agencies or any of them, dealing in securities, money market instruments, foreign exchange, derivatives, or other instruments of like nature.

### Payment and Settlement Functions

The Parliament of India enacted the Payment and Settlement Systems Act, 2007 ('PSS Act, 2007') with an objective to provide for the regulation and supervision of payment systems in India and to designate Reserve Bank of India as the authority for that purpose and for matters connected therewith or incidental thereto.

Payment System has been defined to mean a system that enables payment to be effected between a payer and a beneficiary, involving clearing, payment or settlement service or all of them, but does not include a stock exchange. The explanation to the said definition says that for the purposes of this clause, "payment system" includes the systems enabling credit card operations, debit card operations, smart card operations, money transfer operations or similar operations.

Settlement on the other hand has been defined to mean settlement of payment instructions and includes the settlement of securities, foreign exchange or derivatives or other transactions which involve payment obligations.

Under Section 4 of the PSS Act, 2007, no person shall commence or operate a payment system except with an authorization issued by the RBI. Section 3 of the PSS Act 2007 states that the RBI shall exercise the powers, perform the functions and discharge the duties conferred on it under this Act through a Board to be known as the "Payments Regulatory Board" comprising of the Governor of the Reserve Bank, the Deputy Governor of the Reserve Bank is in-charge of the Payment and Settlement Systems, one officer of the Reserve Bank to be nominated by the Central Board of the Reserve Bank and three persons to be nominated by the Central Government.

Similarly, under Section 8 of the PSS Act, 2007, RBI has the powers to revoke the authorization granted to any person if it contravenes any of the provisions of PSS Act or does not comply with the regulations or fails to comply with the orders or directions issued by the RBI or operates the payment system contrary to the conditions subject to which the authorization was issued. The regulation and supervision of payment systems has been conferred on the RBI by virtue of provisions of Chapter IV of PSS Act, 2007. The regulatory and supervisory controls include the power to determine standards for the functioning of payment systems, power to call for returns, documents or other information, power to enter and inspect payment systems, power to carry out audit and inspections, power to issue directions, etc.

## Consumer Protection Functions

In India, although the provisions of the BR Act, 1949, requires the RBI to bear in mind the vital issue of protection of depositors' interests while granting a banking license or cancellation thereof, giving directions on advances on any banking matter, applying for suspension, winding up, or amalgamation of banks, approving appointment of CEOs or additional directors, removal of CEOs, etc., there is no specific provision under the BR Act, 1949, or any of the other statutes for forming a formal mechanism for redressal of grievances of depositors. In the absence of a specific provision for the purpose, RBI has resorted to its powers under Section 35-A of the BR Act, 1949, to formulate the Banking Ombudsman Scheme for the redressal of grievances of depositors. The Banking Ombudsman provides a forum to bank customers to seek redressal of their most common complaints against banks, including those relating to credit cards, service charges, promises given by the sales agents of banks, but not kept by banks, as also, delays in delivery of bank services.

## Financial Inclusion and Development Functions

The mushrooming of unauthorized and unregulated money lenders in the financial system of the country necessitated the RBI to do something more than what has been provided in the Rule books. Financial literacy or financial inclusion, though, not explicitly expressed in the RBI Act, 1934, or the BR Act, 1949, sub-section (16) of Section 17 of the RBI Act, 1934, enables RBI to do all such matters and things as may be incidental to or consequential to the exercise of its powers or the discharge of its duties under the Act.

Further, India being a country with significant illiteracy, there remains an obligation on the part of the 'State' to educate the people and also to include them into the organised financial system of the country to get the benefits of professional banking system of the country. The amendment to the BR Act, 1949, inserting Section 26-A, which provides for establishment of Depositor Education and Awareness Fund, is a step towards achieving this objective, which makes it amply clear that the statute casts a responsibility on the RBI to focus towards achieving financial literacy in the country. Section 26A provides that the Fund shall be utilised for promotion of depositors' interests and for such other purposes which may be necessary for the promotion of depositors' interests as may be specified by the RBI from time to time. Not only the BR Act, 1949, even the RBI Act, 1934, mandates the RBI to maintain expert staff to study various aspects of rural credit and development, which emphasizes the premier role to be played by RBI in promoting financial literacy and financial inclusion among the citizens living even in the remote areas of the country.

## Right to Issue Bank Notes

Management of currency is one of the core central banking functions of the Reserve Bank for which it derives the necessary statutory powers from Section 22 of the RBI Act, 1934. Along with the Government of India, the Reserve Bank is responsible for the design, production and overall management of the nation's currency, with the goal of ensuring an adequate supply of clean and genuine notes. In consultation with the Government, the Reserve Bank routinely addresses security issues and targets ways to enhance security features to reduce the risk of counterfeiting or forgery of currency notes.

The Paper Currency Act of 1861 conferred upon the Government of India the monopoly of issuing note, thus ending the practice of private and presidency banks issuing currency. Between 1861 and 1935, the Government of India managed the issue of paper currency. In 1935, when the Reserve Bank began operations, it took over the function of note issue from the Office of the Controller of Currency, Government of India.

## Denominations of Notes

The Indian Currency is called the *Indian Rupee* (abbreviated as *Re.* in singular and *Rs.* in plural), and its sub-denomination the *Paisa* (plural *Paise*). At present, notes in India are issued in the denomination of Rs.5, Rs.10, Rs.20, Rs.50, Rs.100, Rs.200, Rs.500 and Rs.2,000. The printing of Rs.1 and Rs.2 denominations has been discontinued.

However, notes in these denominations issued earlier are still valid and in circulation. The Reserve Bank is also authorised to issue notes in the denominations of five thousand rupees and ten thousand rupees or any other denomination, but not exceeding ten thousand rupees that the Central Government may specify. Thus, in terms of Section 24 of RBI Act 1934, notes in denominations higher than ten thousand rupees cannot be issued. The Central Government may, on the recommendation of the Central Board, direct the non-issue or the discontinuance of issue of bank notes of such denominational values as it may specify in this behalf. The Government of India announced the demonetisation of Rs.500 and Rs.1000 bank notes with effect from midnight of November 8, 2016, making these notes invalid. A newly redesigned series of Rs.500 banknote, in addition to a new denomination of Rs. 2000 banknote is in circulation since 10 November 2016.

## Form of Bank Notes

The Department of Currency Management makes recommendations on design of bank notes to the Central Government, forecasts the demand for notes, and ensures smooth distribution of notes and coins throughout the country [Section 25]. It arranges to withdraw unfit notes, administers the provisions of the RBI (Note Refund) Rules, 2009 (these rules deal with the payment of value of the soiled or mutilated notes) and reviews / rationalises the work systems and procedures at the issue offices on an ongoing basis.

## Legal tender character of notes

Section 26 sub-section (1) of the Act states that subject to the provisions of sub-section (2), every bank note shall be legal tender at any place in India in payment or on account for the amount expressed therein, and shall be guaranteed by the Central Government.

Sub-section 2 empowers the Central Government, on recommendation of the Central Board, by notification in the Gazette of India to declare that, with effect from such date as may be specified in the notification, any series of bank notes of any denomination to cease to be legal tender save at such office or agency of the Bank and to such extent as may be specified in the notification.

## Currency Distribution

The Government of India on the advice of the Reserve Bank decides on the various denominations of the notes to be printed. The Reserve Bank coordinates with the Government in designing the banknotes, including their security features.

The printed notes received from Printing Press set up by Government and RBI are issued for circulation both through remittances to banks as also the Reserve Bank counters.

## Coin Distribution

The Indian Coinage Act, 1906 governs the minting of rupee coins, including small coins of the value of less than one rupee. Coins are legal tender in India for unlimited amounts. Fifty paisa coins are legal tender for any sum not exceeding ten rupees and smaller coins for any sum not exceeding one rupee. The Reserve Bank acts as an agent of the Central Government for distribution, issue and handling of the coins and for withdrawing and remitting them back to Government as may be necessary.

## Combating Counterfeiting

The Reserve Bank, in consultation with the Government of India, periodically reviews and upgrades the security features of the bank notes to deter counterfeiting. It also shares information with various law enforcement agencies to address the issue of counterfeiting. It has also issued detailed guidelines to banks and government treasury offices on how to detect and impound counterfeit notes.

## Bank exempt from stamp duty on bank notes

The Bank is not liable to the payment of any stamp duty under the Indian Stamp Act, 1899, in respect of bank notes issued by it {section 29 of the RBI Act}.

## Powers of Central Government to supersede Central Board

Section 30 Sub section (1) of the states that if in the opinion of Central Government the Bank fails to carry out any of the obligations imposed on it by or under the Act, by notification in the Gazette of India, declare the Central Board to be superseded, and thereafter the general superintendence and direction of the affairs of the Bank shall be entrusted to such agency at the Central Government may determine, and such agency may exercise the powers and do all acts and things which may be exercised or done by the Central Board under the Act.

As per sub section 2 of this section when action is taken under this section the Central Government shall cause a full report of the circumstances leading to such action and of the action taken to be laid before Parliament at the earliest possible opportunity and in any case within three months from the issue of the notification superseding the Board.

## Issue of demand bills and notes

Section 31 Sub section (1) of the RBI Act states that no person in India other than the Bank, or, as expressly authorized by the Act the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand of any such person: However cheques or drafts, including hundis, payable to bearer on demand or otherwise may be drawn on a person's account with a banker, shroff or agent.

As per sub section 2 of this section notwithstanding anything contained in the Negotiable Instrument Act, 1881, no person in India other than the Bank or, as expressly authorized by the Act, the Central Government shall make or issue any promissory note expressed to be payable to the bearer of the instrument.

## Banker to the Central Government & State Governments

Reserve Bank acts as banker to the Central Government and all the State Governments in India. As a banker to the Government, the Reserve Bank receives and pays money on behalf of the various Government departments. The Reserve Bank also undertakes to float loans and manage them on behalf of the Governments. It also provides Ways and Means Advances – a short-term interest bearing advance – to the Governments, to meet the temporary mismatches in their receipts and payments. Besides, it arranges for investments of surplus cash balances of the Governments as a portfolio manager. The Reserve Bank also acts as adviser to Government, whenever called upon to do so, on monetary and banking related matters.

The banking functions for the governments are carried out by the Public Accounts Departments at the offices/branches of the Reserve Bank, while management of public debt including floatation of new loans is done at Public Debt Office at offices/branches of the Reserve Bank and by the Internal Debt Management Department at the Central Office.

## Management of Public Debt

The Reserve Bank manages the public debt and issues new loans on behalf of the Central and State Governments. It involves issue and retirement of rupee loans, interest payment on the loan and operational matters about debt certificates and their registration.

The union budget decides the annual borrowing needs of the Central Government. Parameters, such as, interest rate, timing and manner of raising of loans are influenced by the state of liquidity and the expectations of the market. The Reserve Bank's debt management policy aims at minimising the cost of borrowing, reducing the roll-over risk, smoothening the maturity structure of debt, and improving depth and liquidity of Government securities markets by developing an active secondary market.

## Reserve Bank as Banker to Banks

The Reserve Bank, to fulfill this function, opens current accounts of banks with itself, enabling these banks to maintain cash reserves as well as to carry out inter-bank transactions through these accounts. Inter-bank accounts can also be settled by transfer of money through electronic fund transfer system, such as, the Real Time Gross Settlement System (RTGS).

In addition, the Reserve Bank has also introduced the Centralised Funds Management System (CFMS) to facilitate centralised funds enquiry and transfer of funds across Deposit Accounts Department (DADs). This helps banks in their fund management as they can access information on their balances maintained across different DADs from a single location.

As Banker to Banks, the Reserve Bank provides short-term loans and advances to select banks, when necessary, to facilitate lending to specific sectors and for specific purposes. These loans are provided against promissory notes and other collateral given by the banks.

The Reserve Bank also acts as the 'lender of last resort'. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of a bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

## Financial Regulation and Supervision

The Reserve Bank's regulatory and supervisory domain extends not only to the Indian banking system but also to the development financial institutions (DFIs), non-banking financial companies (NBFCs), primary dealers, credit information companies and select segments of the financial markets.

As the regulator and the supervisor of the banking system, the Reserve Bank has a critical role to play in ensuring the system's safety and soundness on an ongoing basis. The objective of this function is to protect the interest of depositors through an effective prudential regulatory framework for orderly development and conduct of banking operations, and to maintain overall financial stability through various policy measures.

## Prudential Norms for Banks

In order to strengthen the balance sheets of banks, the Reserve Bank has been prescribing appropriate prudential norms for them in regard to income recognition, asset classification and provisioning, capital adequacy, investments portfolio and capital market exposures, to name a few. A brief description of these norms is furnished below:

**Capital Adequacy:** The Reserve Bank has instructed banks to maintain adequate capital on a continuous basis. The adequacy of capital is measured in terms of Capital to Risk-Weighted Assets Ratio (CRAR). Under the recently revised framework, banks are required to maintain adequate capital for credit risk, market risk, operational risk and other risks. Basel regulated standardised approach is applicable with road map drawn up for advanced approaches.

**Loans and Advances:** In order to maintain the quality of their loans and advances, the Reserve Bank requires banks to classify their loan assets as performing and non-performing assets (NPA), primarily based on the record of

recovery from the borrowers. NPAs are further categorised into Sub-standard, Doubtful and Loss Assets depending upon age of the NPAs and value of available securities. Banks are also required to make appropriate provisions against each category of NPAs. Banks are also required to have exposure limits in place to prevent credit concentration risk and limit exposures to sensitive sectors, such as, capital markets and real estate.

**Investments:** The Reserve Bank requires banks to classify their investment portfolios into three categories for the purpose of valuation: Held to Maturity (HTM), Available for Sale (AFS) and Held for Trading (HFT). The securities held under HFT and AFS categories have to be marked-to-market periodically and depreciation, if any, needs appropriate provisions by banks. Securities under HTM category must be carried at acquisition / amortised cost, subject to certain conditions.

### Foreign Exchange Reserves Management

The Reserve Bank, as the custodian of the country's foreign exchange reserves, is vested with the responsibility of managing their investment. The legal provisions governing management of foreign exchange reserves are laid down in the Reserve Bank of India Act, 1934.

The Reserve Bank's reserves management function has in recent years grown both in terms of importance and sophistication for two main reasons. First, the share of foreign currency assets in the balance sheet of the Reserve Bank has substantially increased. Second, with the increased volatility in exchange and interest rates in the global market, the task of preserving the value of reserves and obtaining a reasonable return on them has become challenging. The basic parameters of the Reserve Bank's policies for foreign exchange reserves management are safety, liquidity and returns.

***Within this framework, the Reserve Bank focuses on:***

- (a) Maintaining market's confidence in monetary and exchange rate policies.
- (b) Enhancing the Reserve Bank's intervention capacity to stabilise foreign exchange markets.
- (c) Limiting external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of
- (d) crisis, including national disasters or emergencies.
- (e) Providing confidence to the markets that external obligations can always be met, thus reducing the costs at which foreign exchange resources are available to market participants.
- (f) Adding to the comfort of market participants by demonstrating the backing of domestic currency by external assets.

While safety and liquidity continue to be the twin-pillars of reserves management, return optimisation has become an embedded strategy within this framework. The Reserve Bank has framed policy guidelines stipulating stringent eligibility criteria for issuers, counterparties, and investments to be made with them to enhance the safety and liquidity of reserves. The Reserve Bank, in consultation with the Government, continuously reviews the reserves management strategies.

### Transactions in foreign exchange

Section 40 of the Act says that the Bank shall sell to or buy from any authorized person who makes a demand in that behalf at its office in Bombay, Calcutta, Delhi or Madras or at such of its branches as the Central Government may, by order, determine, foreign exchange at such rates of exchange and on such conditions as the Central Government may from time to time by general or special order determine, having regard so far as rates of exchange are concerned to its obligations to the International Monetary Fund:

In this section the term "authorized person" means a person who is entitled by or under the Foreign Exchange Regulation Act, to buy, or as the case may be, sell, the foreign exchange to which his demand relates.

### Market Operations

The Reserve Bank operationalises its monetary policy through its operations in government securities, foreign exchange and money markets.

**Open Market Operations:** Open Market Operations in the form of outright purchase/sale of Government securities are an important tool of the Reserve Bank's monetary management. The Bank carries out such operations in the secondary market on the electronic Negotiated Dealing System – Order Matching (NDS-OM) platform by placing bids and/or taking the offers for securities.

**Liquidity Adjustment Facility Auctions:** The liquidity management operations are aimed at modulating liquidity conditions such that the overnight rates in the money market remains within the informal corridor set by the repo and reverse repo rates for the liquidity adjustment facility (LAF) operations. In a repo transaction, the Reserve Bank infuses liquidity into the system by taking securities as collateral, while in a reverse repo transaction it absorbs liquidity from the system with the Reserve Bank providing securities to the counter parties.

**Market Stabilisation Scheme:** The Market Stabilisation Scheme (MSS) was introduced in April 2004 under which Government of India dated securities/treasury bills could be issued to absorb surplus structural/ durable liquidity created by the Reserve Bank's foreign exchange operations. MSS operations are a sterilisation tool used for offsetting the liquidity impact created by intervention in the foreign exchange markets.

## Payment and Settlement Systems

The regulation and supervision of payment systems is being increasingly recognised as a core responsibility of central banks. Safe and efficient functioning of these systems is an important pre-requisite for proper functioning of financial system and the efficient transmission of monetary policy.

The Payment and Settlement Systems Act, 2007 provides for regulation and supervision of payment systems in India and designates the Reserve Bank as the authority for the purpose. As per the Act, only payment systems authorised by the Reserve Bank can be operated in the country. The Act also provides for the settlement effected under the rules and procedures of the system provider to be treated as final and irrevocable.

The Reserve Bank has put in place an institutional framework and structure for oversight of the payment systems. In 2005, it created a Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) as a Committee of the Central Board. A new department called the Department of Payment and Settlement Systems (DPSS) was constituted to assist the BPSS in performing its functions.

The Reserve Bank has adopted a three-pronged strategy of consolidation, development and integration to establish a modern and robust payment and settlement system which is also efficient and secure. The consolidation revolves around expanding the reach of the existing products by introducing clearing process in new locations.

The Reserve Bank has also taken steps towards integrating the payment system with the settlement systems for government securities and foreign exchange. To facilitate settlement of Government securities transactions, it created the Negotiated Dealing System, a screen-based trading platform.

For settlement of trade in foreign exchange, Government securities and other debt instrument, it has set up the Clearing Corporation of India Limited (CCIL). This plays the role of a central counter party to transactions and guarantees settlement of trade, thus managing the counter party risk.

## Monetary Policy Management

One of the most important functions of central banks is formulation and execution of monetary policy. In the Indian context, the basic functions of the Reserve Bank of India are as enunciated in the Preamble to the RBI Act, Thus, the Reserve Bank's mandate for monetary policy flows from its monetary stability objective. Essentially, monetary policy deals with the use of various policy instruments for inflow and the cost and availability of money in the economy. As macroeconomic conditions change, a central bank may change the choice of instruments in its monetary policy. The overall goal is to promote economic growth and ensure price stability.

## Monetary Policy

Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its control to achieve the goals specified in the Act. The Reserve Bank of India (RBI) is vested with the responsibility of adopting and implementing monetary policy. This responsibility is explicitly mandated under the Reserve Bank of

India Act, 1934. The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Price stability is a necessary precondition to sustainable growth.

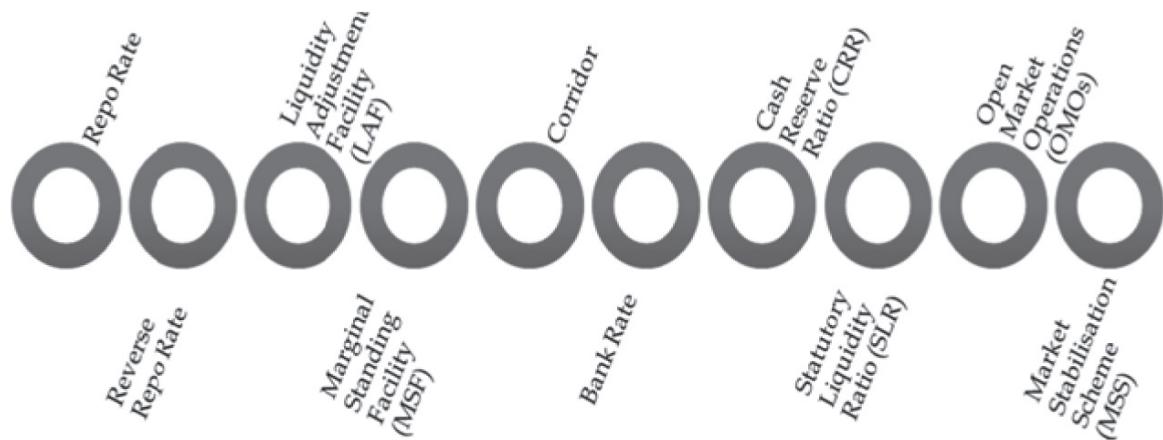
## Monetary Policy Framework

The RBI Act explicitly empowers the Reserve Bank to operate the monetary policy framework of the country.

- The framework aims at setting the policy (repo) rate based on an assessment of the current and evolving macroeconomic situation; and modulation of liquidity conditions to anchor money market rates at or around the repo rate. Repo rate changes transmit through the money market to the entire the financial system, which, in turn, influences aggregate demand – a key determinant of inflation and growth.
- Once the repo rate is announced, the operating framework designed by the Reserve Bank envisages liquidity management on a day-to-day basis through appropriate actions, which aim at anchoring the operating target – the Weighted Average Call Rate (WACR) – around the repo rate.
- The operating framework is fine-tuned and revised depending on the evolving financial market and monetary conditions, while ensuring consistency with the monetary policy stance.

## Instruments of Monetary Policy

There are several direct and indirect instruments that are used for implementing monetary policy.



**Repo Rate:** The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the Liquidity Adjustment Facility (LAF).

- Reverse Repo Rate:** The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.
- Liquidity Adjustment Facility (LAF):** The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of range of tenors. The aim of term repo is to help develop the inter-bank term money market, which in turn can set market based benchmarks for pricing of loans and deposits, and hence improve transmission of monetary policy. The Reserve Bank also conducts variable interest rate reverse repo auctions, as necessitated under the market conditions.
- Marginal Standing Facility (MSF):** A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.
- Corridor:** The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.

**Bank Rate:** It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate is published under Section 49 of the Reserve Bank of India Act, 1934. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.

- **Cash Reserve Ratio (CRR):** The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.
- **Statutory Liquidity Ratio (SLR):** The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.
- **Open Market Operations (OMOs):** These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- **Market Stabilisation Scheme (MSS):** This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the Reserve Bank.

## Constitution of Monetary Policy Committee

Section 45ZB of the Act states that:-

- (1) The Central Government may, by notification in the Official Gazette, constitute a Committee to be called the Monetary Policy Committee of the Bank.
- (2) The Monetary Policy Committee shall consist of the following Members, namely:—
  - (a) the Governor of the Bank—Chairperson, ex officio;
  - (b) Deputy Governor of the Bank, in charge of Monetary Policy—Member, ex officio;
  - (c) one officer of the Bank to be nominated by the Central Board—Member, ex officio; and
  - (d) three persons to be appointed by the Central Government—Members.
- (3) The Monetary Policy Committee shall determine the Policy Rate required to achieve the inflation target.
- (4) The decision of the Monetary Policy Committee shall be binding on the Bank.

## Meetings of Monetary Policy Committee

Section 45ZI of the Act states that:-

- (1) The Bank shall organise at least four meetings of the Monetary Policy Committee in a year.
- (2) The meeting schedule of the Monetary Policy Committee for a year shall be published by the Bank at least one week before the first meeting in that year.
- (3) The meeting schedule may be changed only—
  - (a) by way of a decision taken at a prior meeting of the Monetary Policy Committee; or
  - (b) if, in the opinion of the Governor, an additional meeting is required or a meeting is required to be rescheduled due to administrative exigencies.
- (4) Any change in meeting schedule shall be published by the Bank as soon as practicable.
- (5) The quorum for a meeting of the Monetary Policy Committee shall be four Members, at least one of whom shall be the Governor and in his absence, the Deputy Governor who is the Member of the Monetary Policy Committee.
- (6) The meetings of the Monetary Policy Committee shall be presided over by the Governor, and in his absence by the Deputy Governor who is a Member of the Monetary Policy Committee.

- (7) Each Member of the Monetary Policy Committee shall have one vote.
- (8) All questions which come up before any meeting of the Monetary Policy Committee shall be decided by a majority of votes by the Members present and voting, and in the event of an equality of votes, the Governor shall have a second or casting vote.
- (9) The Central Government may, if it considers necessary, convey its views in writing to the Monetary Policy Committee from time to time.
- (10) The vote of each Member of the Monetary Policy Committee for a proposed resolution shall be recorded against such Member.
- (11) Each Member of the Monetary Policy Committee shall write a statement specifying the reasons for voting in favour of, or against the proposed resolution.
- (12) The procedure, conduct, code of confidentiality and any other incidental matter for the functioning of the Monetary Policy Committee shall be such as may be specified by the regulations made by the Central Board.
- (13) The proceeding of the Monetary Policy Committee shall be confidential.

### Monetary Policy Report

Section 45ZM(1) of the Act provides that the Bank shall, once in every six months, publish a document to be called the Monetary Policy Report, explaining—

- (a) the sources of inflation; and
- (b) the forecasts of inflation for the period between six to eighteen months from the date of publication of the document.

As per sub section 2 of this section the form and contents of the Monetary Policy Report shall be such as may be specified by the regulations made by the Central Board.

### Power to make rules

Section 45ZD sub-section (1) of the Act provides that the Central Government may, by notification in the Official Gazette, make rules for the purpose of carrying out the provisions of this Chapter.

Sub-section 2 of this section states that in particular and without prejudice to the generality of the foregoing power, such rules may provide for—

- (a) the procedure of functioning of the Search-cum-Selection Committee under sub-section (3) of section 45ZC;
- (b) the terms and conditions of appointment, (other than the remuneration and other allowances), of Members of the Monetary Policy Committee under sub-section (2) of section 45ZD; and
- (c) any other matter which is to be, or may be, prescribed by the Central Government by rules.

### PENALTIES

Section 58B of the RBI Act, stipulating Penalties states that:

- (1) Whoever in any application, declaration, return, statement, information or particulars made, required or furnished by or under or for the purposes of any provisions of this Act, or any order, regulation or direction made or given thereunder or in any prospectus or advertisement issued for or in connection with the invitation by any person, of deposits of money from the public willfully makes a statement which is false in any material particular knowing it to be false or willfully omits to make a material statement shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine.
- (2) If any person fails to produce any book, account or other document or to furnish any statement, information or particulars which, under this Act or any order, regulation or direction made or given thereunder, it is his duty to produce or furnish or to answer any question put to him in pursuance of the provisions of this Act or of any order, regulation or direction made or given thereunder, he shall be punishable with fine which may extend to one lakh rupees in respect of each offence and if he persists in such failure or refusal, with further fine which may extend to five thousand rupees for every day, after the first during which the offence continues.

- (3) If any person contravenes the provisions of section 31, he shall be punishable with fine which may extend to the amount of the bill of exchange, hundi, promissory note or engagement for payment of money in respect whereof the offence is committed.
- (4) If any person discloses any credit information, the disclosure of which is prohibited under section 45E, he shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to one thousand rupees, or with both.
- (4A) If any person contravenes the provisions of sub-section (1) of section 45-IA, he shall be punishable with imprisonment for a term which shall not be less than one year but which may extend to five years and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.
- (4AA) If any auditor fails to comply with any direction given or order made by the Bank under section 45MA, he shall be punishable with fine which may extend to ten lakh rupees.
- (4AAA) Whoever fails to comply with any order made by the Company Law Board under sub-section (2) of section 45QA, shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to a fine of not less than five thousand rupees for every day during which such non-compliance continues.
- (5) If any person other than an auditor-
- (a) receives any deposit without being authorised so to do or in contravention of any direction given or order made under Chapter IIIB; or
  - (aa) fails to comply with any direction given or order made by the Bank under any of the provisions of Chapter IIIB; or
  - (b) issues any prospectus or advertisement otherwise than in accordance with section 45J or any order made under section 45J, as the case may be,
    - he shall be punishable with imprisonment for a term which may extend to three years and shall also be liable to fine which may extend,-
    - (i) in the case of a contravention falling under clause (a), to twice the amount of the deposit received; and
    - (ii) in the case of a contravention falling under clause (b), to twice the amount of the deposit called for by the prospectus or advertisement.
- (5A) If any person contravenes any provision of section 45S, he shall be punishable with imprisonment for a term which may extend to two years, or with fine which may extend to twice the amount of deposit received by such person in contravention of that section, or two thousand rupees, whichever is more, or with both:
- Provided that in the absence of special and adequate reasons to the contrary to be mentioned in the judgment of the court, the imprisonment shall not be less than one year and the fine shall not be less than one thousand rupees.
- (5B) Notwithstanding anything contained in section 29 of the Code of Criminal Procedure, 1973 (2 of 1974), it shall be lawful for Metropolitan Magistrate or a Judicial Magistrate of the first class to impose a sentence of the fine in excess of the limit specified in that section on any person convicted under sub-section (5A).
- (6) If any other provision of this Act is contravened or if any default is made in complying with any other requirement of this Act or of any order, regulation or direction made or given or condition imposed thereunder, any person guilty of such contravention or default shall be punishable with fine which may extend to one lakh rupees and where a contravention or default is a continuing one, with further fine which may extend to ten thousand rupees for every day, after the first, during which the contravention or default continues.

### LESSON ROUND-UP

- The Preamble to the Reserve Bank of India Act, 1934 under which it was constituted, specifies its objective as regulation of the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India, generally to operate the currency and credit system of the country to its advantage and operation of the monetary policy framework in India.
- The Central Board of Directors is at the top of the Reserve Bank's organizational structure. Appointed by the Government under the provisions of the Reserve Bank of India Act, 1934, the Central Board has the primary authority and responsibility for the oversight of the Reserve Bank. It delegates specific functions to the Local Boards and various committees. The Governor is the Reserve Bank's chief executive.
- The Government of India on the advice of the Reserve Bank decides on the various denominations of the currency notes to be printed. The Reserve Bank coordinates with the Government in designing the banknotes, including their security features.
- Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its Control to achieve the goals specified in the Act.
- The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy. This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934.
- The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Price stability is a necessary precondition to sustainable growth.
- Repo Rate is the fixed interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the liquidity adjustment facility (LAF).
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### GLOSSARY

- **Repo Rate:** The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the Liquidity Adjustment Facility (LAF).
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### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Discuss the functions of the Reserve Bank of India.
2. Reserve Bank of India as Banker to Banks. Examine.
3. What are the instrument of Monetary Policy?
4. Discuss the Payment and Settlement System of Reserve Bank.
5. Write short notes on:
  - (i) Cash Reserve Ratio
  - (ii) Statutory Liquidity Ratio.

### LIST OF FURTHER READINGS

- Reserve Bank of India Act, 1934 (Bare Act)

### OTHER REFERENCES (INCLUDING WEBSITES / VIDEO LINKS)

- [www.rbi.org.in](http://www.rbi.org.in)



## Lesson 2

# Foreign Exchange Management Act, 1999-Introduction

### ***Key Concepts One Should Know***

- Foreign Exchange Management
- FEMA Rules
- FEMA Regulations

### ***Learning Objectives***

#### **To understand:**

- Concept of FEMA
- Structure and Overall Schemes of FEMA
- Rules and Regulations framed by RBI under FEMA

### ***Regulatory Framework***

- Foreign Exchange Management Act, 1999

### ***Lesson Outline***

- Historical background
- Overview of Foreign Exchange Management Act
- Overall scheme of Foreign Exchange Management Act
- Structure of the Foreign Exchange Management Act
- Rules framed under the Foreign Exchange Management Act
- Regulations issued by Reserve Bank issued under the Foreign Exchange Management Act
- LESSON ROUND-UP
- TEST YOURSELF

## HISTORICAL BACKGROUND

A system of exchange control was for the first time introduced through a series of Rules under the Defence of India Act, 1939 on temporary basis. As the foreign exchange crisis persisted for a long time Foreign Exchange Regulation Act, 1947 was enacted initially for a period of ten years. However, 10 years of economic development did not ease the foreign exchange constraint, FERA permanently entered the statute book in the year 1957.

Subsequently, this Act was replaced by the Foreign Exchange Regulation Act, 1973 which came into force with effect from January 1, 1974. In the year 1974, FERA was completely overhauled with all offences being considered as criminal offences with *mens rea*. The Enforcement Directorate was empowered to arrest any person without even arrest warrant.

In the 1990s, consistent with the general philosophy of economic reforms a sea change relating to the broad approach to reform in the external sector took place. In 1991 government of India initiated the policy of economic liberalization. Foreign investments in many sectors were permitted. This resulted in increased flow of foreign exchange in India and foreign exchange reserves increased substantially.

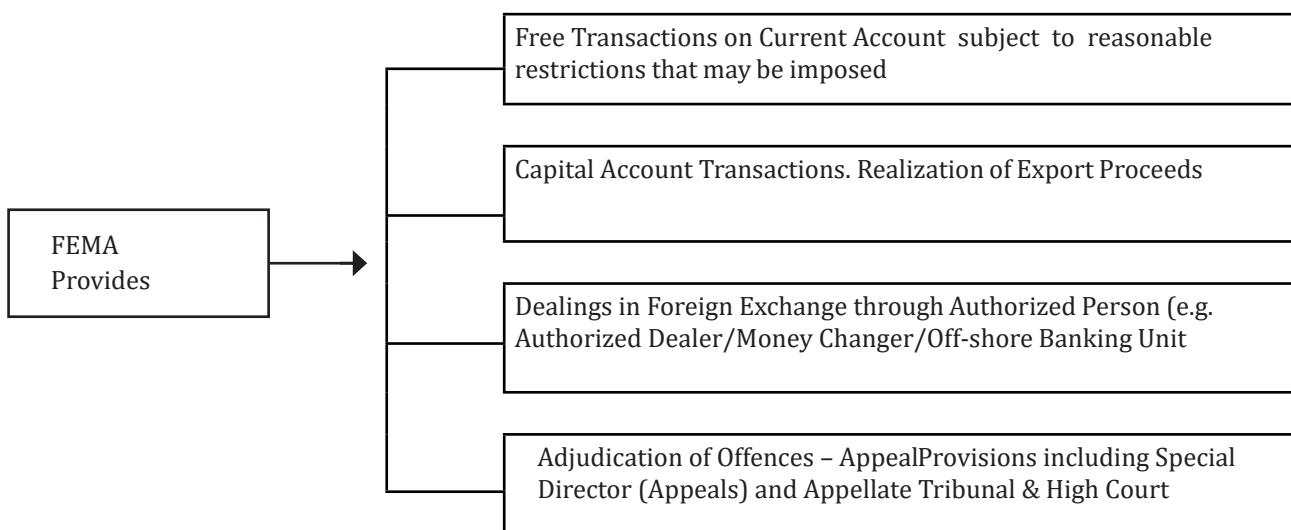
In 1997, the Tarapore Committee on Capital Account Convertibility (CAC), constituted by the Reserve Bank, had indicated the preconditions for Capital Account Convertibility. The three crucial preconditions were fiscal consolidation, a mandated inflation target and, strengthening of the financial system. The Tarapore Committee had also recommended change in the legislative framework governing foreign exchange transactions.

A Bill introduced in the Lok Sabha on 4 August, 1998 was referred to the Standing Committee on Finance which submitted its report to the House on 23 December '98 with suggestion and modifications. As the 12th Lok Sabha was dissolved before any decision could be taken on the Bill, the Bill lapsed consequently. The Bill was again introduced in the 13th Lok Sabha on 25th October 1999 and was passed in the winter session of Parliament in 1999. The President Assent was received on 29th December, 1999.

Finally FEMA came into force w.e.f. 1st June 2000. Accordingly, the Foreign Exchange Regulation Act (FERA) was repealed and replaced by the new Foreign Exchange Management Act (FEMA) with effect from June 2000. The philosophical approach was shifted from that of conservation of foreign exchange to one of facilitating trade and payments as well as developing orderly foreign exchange market.

### Overview of FEMA

The Foreign Exchange Management Act, 1999 was enacted to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India. In fact it is the central legislation that deals with inbound investments into India and outbound investments from India and trade and business between India and the other countries.



## Applicability

Foreign Exchange Management Act, 1999 extends to the whole of India. The Act also applies to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention thereunder committed outside India by any person to whom this Act applies.

FEMA has considerably liberalised provisions in respect of management of foreign exchange. However, in extraordinary situations may arise. The Central Government has been empowered to suspend operation of any or all provisions of FEMA in public interest, by issuing a notification. The Central Government has also been empowered to relax suspension by issuing a notification.

## Overall Scheme of FEMA

FEMA makes provisions for dealings in foreign exchange. Broadly, all Current Account Transactions are free. However, Central Government can impose reasonable restrictions by issuing rules (Section 3 of FEMA). Capital Account Transactions are permitted to the extent specified by RBI by issuing Regulations. (Section 6 of FEMA)

FEMA envisages that RBI shall have a controlling role in management of foreign exchange. Since RBI cannot directly handle foreign exchange transactions, it authorizes "Authorised Persons" to deal in foreign exchange. RBI has been empowered to issue directions to such "Authorised Persons" under Section 11.

FEMA also makes provisions for enforcement, penalties, adjudication and appeal. The FEMA 1999 contains only basic legal framework. The practical aspects are covered in Rules made by Central Government and Regulations made by RBI.

FDI Policy announced by Department for Promotion of Industry & Internal Trade, Ministry of Commerce and Industry directly relevant to understanding the provisions of FEMA. Instructions/Guidelines etc. of Ministry of Finance and Securities and Exchange Board of India (SEBI) become relevant when (ECB) /ADR/GDR and capital market is involved.

## FEMA Structure

The legislations, rules and regulations, governing Foreign Exchange Management are as under:

- FEMA contains 7 Chapters divided into 49 sections of which 12 sections cover operational part and the rest deals with contravention, penalties, adjudication, appeals, enforcement directorate, etc.

CHAPTER I – Preliminary (Section 1&2)

CHAPTER II- Regulation and Management of Foreign Exchange (Section 3 –9) CHAPTER III – Authorised Person (Section 10 –12)

CHAPTER IV – Contravention and Penalties (Section 13-15) CHAPTER V – Adjudication and Appeal (Section 16- 35) CHAPTER VI – Directorate of Enforcement (Section 36-38) CHAPTER VII- Miscellaneous (Section 39 – 49)

- Rules made by Ministry of Finance under Section 46 of FEMA (Subordinate or delegated Legislations)
- Regulations made by RBI under Section 47 of FEMA (Subordinate or delegated Legislations)
- Master Direction issued by RBI on every year
- Foreign Direct Investment policy issued by Department of Industrial Policy and Promotion (DIPP). Now DIPP renamed as Department for Promotion of Industry and Internal Trade (DPIIT).
- Notifications and Circulars issued by Reserve Bank of India.

Besides the FEMA, there are Set of Rules, Regulations and Master Directions under the Act to ensure effective implementation of the Act.

**The Rules made under FEMA are as follows:**

1. FEM (Non-debt Instruments) Rules, 2019
2. FEM (Encashment of Draft, Cheque, Instrument and Payment of Interest) Rules, 2000
3. FEM (Authentication of Documents) Rules, 2000
4. FEM (Current Account Transaction) Rules, 2000
5. FEM (Adjudication Proceedings and Appeal) Rules, 2000
6. FEM (Compounding of Proceedings) Rules, 2000

**The Regulations made under FEMA are as follows:**

1. FEM (Debt Instruments) Regulations, 2019
2. FEM (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019
3. FEM (Acquisition and Transfer of Immovable Property Outside India) Regulations, 2015
4. FEM (Borrowing and Lending in Rupees) Regulations, 2000
5. FEM (Borrowing or Lending in Foreign Exchange) Regulations, 2000
6. FEM (Deposit) Regulations, 2016
7. FEM (Export and Import of Currency) Regulations, 2015
8. FEM (Guarantees) Regulations, 2000
9. FEM (Establishment in India of Branch office or a Project office or any other Place of Business) Regulations, 2016
10. FEM (Export of Goods and Services) Regulations, 2015
11. FEM (Foreign Currency Accounts by a Person Resident in India) Regulations, 2015
12. FEM (Insurance) Regulations, 2015
13. FEM (Manner of Receipt and Payment) Regulations, 2016
14. FEM (Permissible Capital Account Transactions) Regulations, 2000
15. FEM (Possession and Retention of Foreign Currency) Regulations, 2015
16. FEM (Realization, Repatriation and Surrender of Foreign Exchange) Regulations, 2015
17. FEM (Remittance of Assets) Regulations, 2016
18. FEM (Foreign Exchange Derivative Contracts) Regulations, 2000
19. FEM (Transfer or Issue of any Foreign Security) Regulations, 2004
20. FEM (Crystallization of inoperative Foreign Currency Deposits) Regulations, 2014
21. F.E.M (Transfer or Issue of any foreign Security) Regulations, 2004
22. FEM (International Financial Services Centre) Regulations, 2015
23. FEM (Regularization of Assets Held Abroad by a Person Resident in India) Regulations, 2015

**LESSON ROUND-UP**

- The Foreign Exchange Management Act has repealed the FERA.
- The Foreign Exchange Management Act, 1999 is an Act to facilitate external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.
- Foreign Exchange Management Act, 1999 extends to the whole of India. The Act also applies to all branches, offices and agencies outside India owned or controlled by a person resident in India and also to any contravention there under committed outside India by any person to whom this Act applies.
- FEMA makes provisions for dealings in foreign exchange. Broadly, all Current Account Transactions are free. However Central Government can impose reasonable restrictions by issuing Rules.
- Capital Account Transactions are permitted to the extent specified by RBI by issuing Regulations.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. State the overview of Foreign Exchange Management Act, 1999.
2. Discuss overall scheme of Foreign Exchange Management Act, 1999.
3. Discuss structure of the Foreign Exchange Management Act, 1999.
4. List out the Rules framed under the Foreign Exchange Management Act, 1999.
5. List out the Regulations issued by Reserve Bank issued under the Foreign Exchange Management Act, 1999.



## Lesson 3

# Foreign Exchange Transactions & Compliances

### ***Key Concepts One Should Know***

- Authorised Person
- Capital Account Transaction
- Current Account Transaction
- Foreign Exchange
- Foreign Security

### ***Learning Objectives***

#### **To understand:**

- Concept of Current Account Transactions
- Capital Account Transactions
- Provisions of Realisation, Repatriation and Surrender of Foreign Currency
- Limits for possession or retention of foreign currency or foreign coins
- Procedure for Adjudication, Appeal and Compounding.

### ***Regulatory Framework***

- Foreign Exchange Management Act, 1999
- Foreign Exchange Management (Current Account Transactions) Rules, 2000
- Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000

### ***Lesson Outline***

- Foreign Exchange
- Foreign Securities
- Current Account Transactions
- Capital Account Transactions
- Acquisition & Transfer of immovable property outside India
- Realisation & Repatriation of Foreign Exchange
- Adjudication
- Compounding of contraventions
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

The Foreign Exchange Regulation Act, 1973, which was enacted to consolidate and amend the law in several respects encompassing the experience gained over few decades of implementation of the earlier enactment of 1947, had outlived its purpose in the light of the liberalization policies introduced in 1991.

The Foreign Exchange Regulation Act, since then had been reviewed and amendments were made as part of ongoing process of economic liberalization relating to foreign investment and foreign trade for closer interaction with the world economy. During the subsequent period, the Central Government decided further review of the Foreign Exchange Regulation Act in the light of developments and experience in relation to foreign trade and investment. It was at that time felt, that a better course would be to repeal the Foreign Exchange Regulation Act and enact a new legislation.

Accordingly, taking into consideration the developments such as substantial increase in foreign exchange reserves, growth in foreign trade, rationalization of tariffs, current account convertibility etc., the Foreign Exchange Management Bill, to repeal and replace the Foreign Exchange Regulation Act was introduced in the Lok Sabha. But before the Bill came up for discussion and approval, the Lok Sabha was dissolved. Subsequently, certain modifications were made to the original Bill and a modified Bill was presented and passed by both the Houses of Parliament. The Foreign Exchange Management Act received the assent of the President on 9th December, 1999 and brought into force with effect from 1<sup>st</sup> June, 2000. Foreign Exchange Management Act, 1999 is an Act to facilitate external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

## IMPORTANT DEFINITIONS

Section 2 of the Foreign Exchange Management Act defines various terms used in the Act, and certain important definitions are given below:

### Adjudicating Authority [Section 2(a)]

According to clause (a) of Section 2 'Adjudicating Authority' means an officer authorised under Sub-section (1) of Section 16 for the purposes of adjudication in respect of penalties under Section 13. Section 16 empowers the Central Government, to appoint, by an order published in the Official Gazette, as many officers as it may think fit as the adjudicating authorities for holding an enquiry in the manner prescribed after giving the person alleged to have committed any contravention, an opportunity of being heard.

### Appellate Tribunal [Section 2(b)]

'Appellate Tribunal' means Appellate Tribunal for Foreign Exchange to hear appeals against the orders of the adjudicating authorities and Special Directors (Appeals) under the Act.

### Authorised Person [Section 2(c)]

The term authorised person is defined to include an authorised dealer, money changer, offshore banking unit or any other person for the time being authorised to deal in foreign exchange or foreign securities.

### Capital Account Transaction [Section 2(e)]

'Capital account transaction' has been defined to mean any transaction which alters the assets or liabilities including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of person resident outside India and includes the transactions specified in Sub-section (3) of Section 6 of the Act.

### Currency Notes [Section 2(i)]

'Currency Notes' means and includes cash in the form of coins and bank notes. In fact, it means money and such bank notes or other paper money as are authorised by law and circulate from hand to hand as a medium of exchange.

### Current Account Transaction [Section 2(j)]

The term current account transaction has been defined to mean a transaction other than a capital account transaction and includes payments due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course of business; payments due as interest on loan and as net income

from investments; remittances for living expenses of parents, spouse and children residing abroad and expenses in connection with foreign travel, education and medical care of parents, spouse and children.

Under the Act freedom has been granted for selling and drawing of foreign exchange to or from an authorized person for undertaking current account transactions. However, the Central Government has been vested with powers in consultation with Reserve Bank to impose reasonable restrictions on current account transactions. The Central Government has framed Foreign Exchange Management (Current Account Transactions) Rules, 2000 dealing with various aspects of current account transactions.

### Foreign Exchange [Section 2(n)]

The term 'foreign exchange has been defined to mean foreign currency and includes deposits, credits, balance payable in foreign currency, drafts, travelers cheques, letters of credit, bills of exchange expressed or drawn in Indian currency but payable in any foreign currency. Any draft, travelers cheque, letters of credit or bills of exchange drawn by banks, institutions or persons outside India but payable in Indian currency has also been included in the definition of foreign exchange.

### Foreign Security [Section 2(o)]

The term Foreign Security has been defined to mean any security, in the form of shares, stocks, bonds, debentures or any other instrument denominated or expressed in foreign currency and includes securities expressed in foreign currency but where redemption or any form of return such as interest or dividend is payable in Indian currency.

Transfer or issue of a foreign security is a capital account transaction within the meaning of Section 6(3)(a) of the Act. The Reserve Bank of India has made Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2000 for regulation, acquisition and transfer of a foreign security by a person resident in India i.e. investment by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India.

### Person [Section 2(u)]

The definition of the term 'person includes, an individual, a Hindu Undivided Family, a company, a firm, an association of persons or body of individuals whether incorporated or not; any agency, office or branch owned or controlled by such persons. Even every artificial juridical person not falling within the above definition has been treated as person as per clause (u) of Section 2.

### Person Resident in India [Section 2(v)]

The expression 'Person resident in India has been defined to mean a person residing in India for more than 182 days during the course of the preceding financial year. However, two categories of persons are excluded from the purview of definition.

The first category includes any person who has gone out of India or who stays outside India for or on taking up employment outside India, or for carrying on outside India a business or vocation. The definition also includes person who stays outside India for any other purpose in such circumstances as would indicate his intention to stay outside India for an uncertain period. The second category of persons which have been excluded from the definition of person resident in India include:

A person who has come to stay or stays in India, in either case otherwise than—

- (i) for or taking up employment in India; or
- (ii) for carrying on in India a business or vocation in India; or
- (iii) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period.

## REGULATION AND MANAGEMENT OF FOREIGN EXCHANGE

Chapter II of the Act containing Sections 3-9 deals with Regulation and Management of Foreign Exchange. Section 3 prohibits any person other than an authorised person from dealing in or transferring any foreign exchange or

foreign security to any person or making any payment to or for the credit of any person resident outside India in any manner or receiving otherwise through an authorised person any payment by order or on behalf of any person resident outside India in any manner except as provided in the Act, rules or regulations made thereunder or with the general or special permission of the Reserve Bank of India.

Section 3(d) prohibits a person to enter into any financial transaction in India as consideration for or in association with acquisition or creation or transfer of a right to acquire, any asset outside India by any person, except as otherwise provided in the Act and rules or regulations made thereunder. For this purpose, financial transaction has been defined to mean making any payment to or for the credit of any person or receiving any payment for, by order or on behalf of any person. Financial transaction also includes drawing, issuing or negotiating any bill of exchange or promissory note or transferring any security or acknowledging any debt.

## CURRENT ACCOUNT TRANSACTIONS

Section 5 of the Act allows any person to sell or draw foreign exchange to or from an authorised person if such sale or drawl is a current account transaction as defined under Section 2(j) of the Act. However, the Central Government may, in the public interest and in consultation with the Reserve Bank impose reasonable restrictions for current account transactions.

Foreign Exchange Management (Current Account Transactions) Rules, 2000 defines the term 'Drawal' as to mean drawal of foreign exchange from an authorised person and includes opening of Letter of Credit or use of International Credit Card or International Debit Card or ATM Card or any other thing by whatever name called which has the effect of creating foreign exchange liability.

## Prohibition on drawal of foreign exchange for certain transactions

Rule 3 prohibits the drawal of foreign exchange for the purposes of transactions specified in the Schedule I or a travel to Nepal and/or Bhutan or a transaction with a person resident in Nepal or Bhutan. However, in the case of transaction with a person resident in Nepal and Bhutan, the prohibition may be exempted by RBI subject to such terms and conditions as it may consider necessary. Schedule I to the Rules enumerate the situations in which the drawal of foreign exchange is prohibited. These are as follows:

- Remittance out of lottery winnings
- Remittance of income from racing/riding etc. or any other hobby
- Remittance for purchase of lottery tickets, banned/ prescribed magazine, football pools, sweep stakes etc
- Payment of commission on exports made towards equity investment in joint ventures/ wholly owned subsidiaries abroad of Indian Companies
- Payment of Commission on exports under Rupee State Credit Route, except commission upto 10% of invoice value of exports of tea and tobacco
- Payment related to 'call back service' of telephone
- Remittance of interest income on funds held in Non-resident Special Rupee Scheme Account.

## Prior approval of Government of India for certain transactions

Rule 4 requires prior approval of the Government of India for the transactions as specified in Schedule II. However, this does not apply to the cases where the payment is made out of funds held in Resident Foreign Currency Account (RFC) of the remitter.

## Prior approval of Reserve Bank for certain transaction

Rule 5 of the Foreign Exchange Management (Current Account Transactions) Amendment Rules, 2015, governs every drawal of foreign exchange for transactions included in Schedule III. However, Rule 5 does not apply to those cases where the payment is made out of funds held in Resident Foreign Currency (RFC) Account of the remitter.

### Transactions included in Schedule III

#### 1. Facilities for individuals—

Individuals can avail of foreign exchange facility for the following purposes within the limit of USD 2,50,000 only. Any additional remittance in excess thereof requires prior approval of the Reserve Bank of India.

- (i) Private visits to any country (except Nepal and Bhutan)
- (ii) Gift or donation.
- (iii) Going abroad for employment
- (iv) Emigration
- (v) Maintenance of close relatives abroad
- (vi) Travel for business, or attending a conference or specialised training or for meeting expenses for meeting medical expenses, or check-up abroad, or for accompanying as attendant to a patient going abroad for medical treatment/ check-up.
- (vii) Expenses in connection with medical treatment abroad
- (viii) Studies abroad
- (ix) Any other current account transaction

However, the purposes mentioned at item numbers (iv), (vii) and (viii), the individual may avail of exchange facility for an amount in excess of the limit prescribed under the Liberalised Remittance Scheme as provided in regulation 4 to FEMA Notification 1/2000-RB, dated the 3rd May, 2000 (Liberalised Remittance Scheme) if it is so required by a country of emigration, medical institute offering treatment or the university, respectively:

Further, if an individual remits any amount under the said Liberalised Remittance Scheme in a financial year, then the applicable limit for such individual would be reduced from USD 250,000 (US Dollars Two Hundred and Fifty Thousand Only) by the amount so remitted:

Further more a person who is resident but not permanently resident in India and

- (a) is a citizen of a foreign State other than Pakistan; or
- (b) is a citizen of India, who is on deputation to the office or branch of a foreign company or subsidiary or joint venture in India of such foreign company,

may make remittance up to his net salary (after deduction of taxes, contribution to provident fund and other deductions).

*Explanation:* For the purpose of this item, a person resident in India on account of his employment or deputation of a specified duration (irrespective of length thereof) or for a specific job or assignments, the duration of which does not exceed three years, is a resident but not permanently resident:

It is to be noted that a person other than an individual may also avail of foreign exchange facility, *mutatis mutandis*, within the limit prescribed under the said Liberalised Remittance Scheme for the purposes mentioned herein above.

## 2. Facilities for persons other than individual

The following remittances by persons other than individuals require prior approval of the Reserve Bank of India.

- (i) Donations exceeding one per cent. of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for-
  - (a) creation of Chairs in reputed educational institutes,
  - (b) contribution to funds (not being an investment fund) promoted by educational institutes; and
  - (c) contribution to a technical institution or body or association in the field of activity of the donor Company.
- (ii) Commission, per transaction, to agents abroad for sale of residential flats or commercial plots in India exceeding USD 25,000 or five percent of the inward remittance whichever is more.
- (iii) Remittances exceeding USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.
- (iv) Remittances exceeding five per cent of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses."

## CAPITAL ACCOUNT TRANSACTION

Section 6 of the FEMA allows capital account transactions subject however to certain conditions. This section empowers the Reserve Bank of India to specify, in consultation with the Central Government, any class or classes of capital account transactions permissible and the limit up to which foreign exchange shall be admissible for such transactions. However, Reserve Bank shall not impose any restrictions on the drawal of foreign exchange for payments due on account of amortization of loans or for depreciation of direct investments in the ordinary course of business.

The Reserve Bank of India may, by regulations, prohibit, restrict or regulate the transfer or issue of any foreign security by a person resident in India or by a person resident outside India. Reserve Bank of India may also regulate, prohibit or restrict transfer or issue of any security or foreign security through any branch office, or agency in India of a person resident outside India. Any borrowing or lending in foreign exchange in whatever form or by whatever name called may also be regulated or prohibited by the Reserve Bank. Similarly, RBI may also prohibit or restrict any borrowing or lending in rupees in whatever form or by whatever name called between a person resident in India and a person resident outside India. Deposits between person's resident in India and person's resident outside India may be regulated or prohibited by the Reserve Bank of India. RBI may also regulate the export, import or holding of currency or currency notes.

Acquisition or transfer of immovable property other than on lease not exceeding five years in India by person resident in India or a person resident outside India may be prohibited or regulated by the Reserve Bank of India. RBI has also been empowered to prohibit or regulate giving of guarantee or surety in respect of any debt, obligation or other liability incurred by a person resident in India and owed to a person resident outside India or by a person resident outside India.

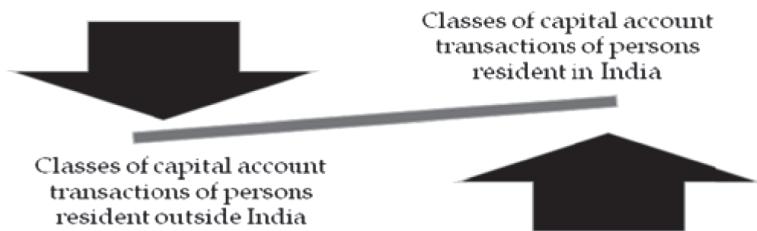
Sub-section (4) allows a person resident in India to hold, own, transfer or invest in foreign currency, foreign security or any immovable property situated outside India, if such currency, security or property was acquired, held or owned by such person when he was resident outside India or inherited from a person who was resident outside India. Similarly, a person resident outside India is permitted to hold, own, transfer or invest in Indian currency, security, or any immovable property situated in India if such currency, security or property was acquired, held or owned by such person when he was resident in India or inherited from a person who was resident in India.

Reserve Bank of India under sub-section (6) has been empowered to regulate, prohibit, restrict establishment in India of a branch, office or other place of business by a person resident outside India for carrying on any activity relating to such branch, office or other place of business.

## Permissible Capital Account Transactions

Schedule I & II to Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000 classifies the capital account transactions of a person under the following two heads viz.

## Classes of Capital Account Transactions



### Classes of Capital Account Transactions by Persons Resident in India

Investment by a person resident in India in foreign securities

Foreign currency loans raised in India and abroad by a person resident in India

Transfer of immovable property outside India by a person resident in India

Guarantees issued by a person resident in India in favour of a person resident outside India

Export, import and holding of currency / currency notes

Loans and overdrafts by a person resident in India from a person resident outside India

Maintenance of foreign currency accounts in India and outside India by a person resident in India.

Taking out of insurance policy by a person resident in India from an insurance company outside India

Loans and overdrafts by a person resident in India to a person resident outside India

Remittance outside India of capital assets of a person resident in India

Sale and purchase of foreign exchange derivatives in India and abroad and commodity derivatives abroad by a person resident in India

## Classes of Capital Account Transactions by Persons Resident Outside India

Investment in India by a person resident outside India, that is to say:

- (a) issue of security by a body corporate or an entity in India and investment therein by a person resident outside India; and
- (b) investment by way of contribution by a person resident outside India to the capital of a firm or a proprietorship concern or an association of persons in India.

Acquisition and transfer of immovable property in India by a person resident outside India

Guarantee by a person resident outside India in favour of, or on behalf of a person resident in India

Import and export of currency/currency notes into/from India by a person resident outside India.

Deposits between a person resident in India and a person resident outside India

Foreign Currency accounts in India of a person resident outside India

Remittance outside India of capital assets in India of a person resident outside India.

Subject to the provisions of the Act, or rules, or regulations or directions or orders made or issued thereunder, any person may sell or draw foreign exchange to or from an authorised person for the above mentioned capital account transactions provided the transactions are within the limit, if any, specified in the Regulations relevant to the transaction. However, no person is allowed to undertake or sell or draw foreign exchange to or from an authorised person for any capital account transaction except as provided in the Act, Rules or regulations made thereunder.

Similarly, except as otherwise provided in the Act, no person resident outside India is entitled to make investment in India, in any form, in any company or partnership firm or proprietary concern or any entity whether incorporated or not, which is engaged or proposed to engage in the business of chit funds, or Nidhi company, or in agricultural or plantation activities, or real estate business, or construction of farm houses, or trading in Transferable Development Rights (TDRs). For this purpose real estate business includes development of townships, construction of residential/commercial premises, roads or bridges.

The payment for investment are required to be made by remittance from abroad through normal banking channels or by debit to an account of the investor maintained with an authorised person in India in accordance with the regulation made by the Reserve Bank of India. Every person selling or drawing foreign exchange to or from an authorised person for a capital account transaction is required to furnish to Reserve Bank a declaration within the time specified in the regulations relevant to the transactions.

## ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY OUTSIDE INDIA BY A PERSON RESIDENT IN INDIA

### Modes of acquiring property outside India by a resident

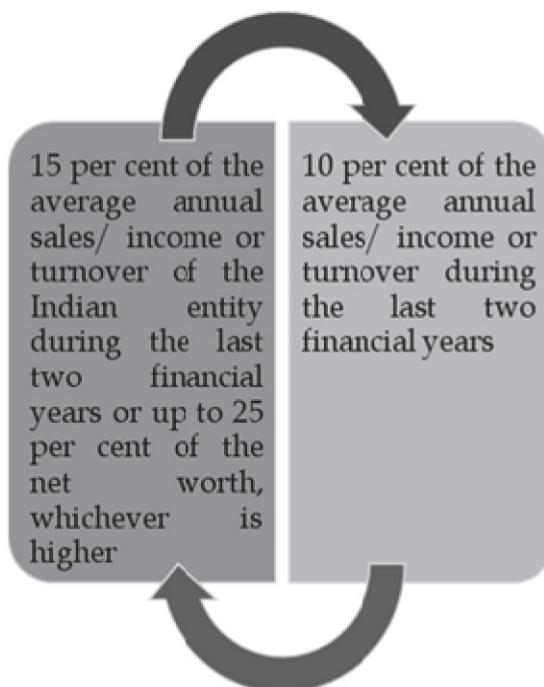
According to section 6(4) of the of Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations, 2015, a person resident in India can hold, own, transfer or invest in any immovable property situated outside India if such property was acquired, held or owned by him/ her when he/ she was resident outside India or inherited from a person resident outside India.

1. A resident can acquire immovable property outside India by way of gift or inheritance from:
  - (a) a person resident in India can hold, own, transfer or invest in any immovable property situated outside India if such property was acquired, held or owned by him/ her when he/ she was resident outside India or inherited from a person resident outside India.; or
  - (b) a person resident in India who had acquired such property on or before July 8, 1947 and continued to be held by him with the permission of the Reserve Bank.
  - (c) a person resident in India who has acquired such property in accordance with the foreign exchange provisions in force at the time of such acquisition.
2. A resident can purchase immovable property outside India out of foreign exchange held in his/ her Resident Foreign Currency (RFC) account.
3. A resident can acquire immovable property outside India jointly with a relative who is a person resident outside India, provided there is no outflow of funds from India.

### Acquisition under the Liberalised Remittance Scheme (LRS)

A resident individual can send remittances under the Liberalised Remittance Scheme for purchasing immovable property outside India.

### Companies having overseas offices



## REALISATION, REPATRIATION AND SURRENDER OF FOREIGN CURRENCY

Section 8 of the Foreign Exchange Management Act, 1999 requires the person resident in India to make all reasonable efforts to realise and repatriate the foreign exchange due or accrued as per the directions of the Reserve Bank.

In exercise of the powers conferred by Section 8, Section 10(6), Section 47(2)(c) of the Foreign Exchange Management Act, 1999, the Reserve Bank issued Foreign Exchange Management (Realisation, Repatriation and Surrender of Foreign Exchange) Regulations, 2015 relating to the manner of, and the period for, realisation of foreign exchange, repatriation of realised foreign exchange to India and its surrender.

### Duty of persons to realise foreign exchange due

A person resident in India to whom any amount of foreign exchange is due or has accrued shall, save as otherwise provided under the provisions of the Act, or the rules and regulations made thereunder, or with the general or special permission of the Reserve Bank, take all reasonable steps to realise and repatriate to India such foreign exchange, and shall in no case do or refrain from doing anything, or take or refrain from taking any action, which has the effect of securing -

- (a) that the receipt by him of the whole or part of that foreign exchange is delayed; or
- (b) that the foreign exchange ceases in whole or in part to be receivable by him.

It may be noted that 'Foreign exchange due' means the amount which a person has a right to receive or claim in foreign exchange.

### Manner of Repatriation

On realisation of foreign exchange due, a person shall repatriate the same to India, namely bring into, or receive in, India and -

- (a) sell it to an authorised person in India in exchange for rupees; or
- (b) retain or hold it in account with an authorised dealer in India to the extent specified by the Reserve Bank; or
- (c) use it for discharge of a debt or liability denominated in foreign exchange to the extent and in the manner specified by the Reserve Bank.

A person shall be deemed to have repatriated the realised foreign exchange to India when he receives in India payment in rupees from the account of a bank or an exchange house situated in any country outside India, maintained with an authorised dealer.

### Period for surrender of realised foreign exchange

A person not being an individual resident in India shall sell the realised foreign exchange to an authorised person, within the period specified below :-

- (i) foreign exchange due or accrued as remuneration for services rendered, whether in or outside India, or in settlement of any lawful obligation, or an income on assets held outside India, or as inheritance, settlement or gift, within seven days from the date of its receipt;
- (ii) in all other cases within a period of ninety days from the date of its receipt.

### Period for surrender in certain cases

Any person not being an individual resident in India who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to an authorised person under sub-section (5) of Section 10 of the FEMA does not use it for such purpose or for any other purpose for which purchase or acquisition of foreign exchange is permissible under the provisions of the Act or the rules or regulations or direction or order made thereunder, shall surrender such foreign exchange or the unused portion thereof to an authorised person within a period of sixty days from the date of its acquisition or purchase by him.

Where the foreign exchange acquired or purchased by any person not being an individual resident in India from an authorised person is for the purpose of foreign travel, then, the unspent balance of such foreign exchange shall, save as otherwise provided in the regulations made under the Act, be surrendered to an authorised person—

- (i) within ninety days from the date of return of the traveller to India, when the unspent foreign exchange is in the form of currency notes and coins; and
- (ii) within one hundred eighty days from the date of return of the traveller to India, when the unspent foreign exchange is in the form of travellers cheques.

### Period for surrender of received/realised/unspent/unused foreign exchange by Resident individuals

A person being an individual resident in India shall surrender the received/ realised/ unspent/ unused foreign exchange whether in the form of currency notes, coins and travelers cheques, etc. to an authorised person within a period of 180 days from the date of such receipt/ realisation/ purchase/ acquisition or date of his return to India, as the case may be.

#### **Exemption**

The Foreign Exchange Management (Realisation, Repatriation and Surrender of Foreign Exchange) Regulations, 2015 does not apply to foreign exchange in the form of currency of Nepal or Bhutan.

### REMITTANCE OF ASSETS

In exercise of the powers conferred by Section 47 of the Foreign Exchange Management Act, the Reserve Bank issued the Foreign Exchange Management (Remittance of Assets) Regulations, 2016 in respect of remittance outside India by a person whether resident in India or not, of assets in India.

Remittances by individuals not being NRIs/ PIOs.

'Remittance of assets' means remittance outside India of funds in a deposit with a bank/ firm/ company, provident fund balance or superannuation benefits, amount of claim or maturity proceeds of insurance policy, sale proceeds of shares, securities, immovable property or any other asset held in India in accordance with the provisions of the Foreign Exchange Management Act, 1999 (FEMA) or rules/ regulations made there under.

Authorised Dealer (AD) may allow remittance of assets by a foreign national where:

- (ii) the person has retired from employment in India;
- (iii) the person has inherited from a person referred to in section 6(5) of the Act;
- (iv) the person is a non-resident widow/widower and has inherited assets from her/his deceased spouse who was an Indian national resident in India.

The remittance should not exceed USD one million per financial year. This limit, however, will not cover sale proceeds of assets held on repatriation basis. In case the remittance is made in more than one instalment, the remittance of all instalments should be made through the same AD on submission of documentary evidence.

- (v) the remittance is in respect of balances held in a bank account by a foreign student who has completed his/ her studies, provided such balance represents proceeds of remittances received from abroad through normal banking channels or rupee proceeds of foreign exchange brought by such person and sold to an authorised dealer or out of stipend/ scholarship received from the Government or any organisation in India.

These facilities are not available for citizens of Nepal or Bhutan or a PIO.

### Remittances by NRIs/ PIOs

**'Non-Resident Indian' (NRI)** means a person resident outside India who is a citizen of India.

A **'Person of Indian Origin (PIO)'** is a person resident outside India who is a citizen of any country other than Bangladesh or Pakistan or such other country as may be specified by the Central Government, satisfying the following conditions:

Who was a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955; or

- (i) Who belonged to a territory that became part of India after the 15th day of August, 1947; or
- (ii) Who is a child or a grandchild or a great grandchild of a citizen of India or of a person referred to in clause (a) or (b); or
- (iii) Who is a spouse of foreign origin of a citizen of India or spouse of foreign origin of a person referred to in clause (a) or (b) or (c).

*Explanation:* PIO will include an 'Overseas Citizen of India' cardholder within the meaning of Section 7(A) of the Citizenship Act, 1955.

***ADs may allow NRIs/ PIOs, on submission of documentary evidence, to remit up to USD one million, per financial year:***

- (i) out of balances in their non-resident (ordinary) (NRO) accounts/ sale proceeds of assets/ assets acquired in India by way of inheritance/ legacy;
- (ii) in respect of assets acquired under a deed of settlement made by either of his/ her parents or a relative as defined in Companies Act, 2013. The settlement should take effect on the death of the settler;
- (iii) in case settlement is done without retaining any life interest in the property i.e. during the lifetime of the owner/ parent, it would tantamount to regular transfer by way of gift and the remittance of sale proceeds of such property would be guided by the extant instructions on remittance of balance in the NRO account;

In case the remittance is made in more than one instalment, the remittance of all instalments should be made through the same AD. Where the remittance is to be made from the balances held in the NRO account, the Authorised Dealer should obtain an undertaking from the account holder stating that the said remittance is sought to be made out of the remitter's balances held in the account arising from his/ her legitimate receivables in India and not by borrowing from any other person or a transfer from any other NRO account and if such is found to be the case, the account holder will render himself/ herself liable for penal action under FEMA.

### **Remittances by companies/ entities**

ADs may allow remittances by Indian companies under liquidation on directions issued by a Court in India/ orders issued by official liquidator in case of voluntary winding up on submission of:

- (i) Auditor's certificate confirming that all liabilities in India have been either fully paid or adequately provided for.
- (ii) Auditor's certificate to the effect that the winding up is in accordance with the provisions of the Companies Act.
- (iii) In case of winding up otherwise than by a court, an auditor's certificate to the effect that there are no legal proceedings pending in any court in India against the applicant or the company under liquidation and there is no legal impediment in permitting the remittance.

ADs may also allow Indian entities to remit their contribution towards the provident fund/ superannuation/ pension fund in respect of their expatriate staff resident but "not permanently resident" in India.

### **Remittances/ winding up proceeds of branch/ office**

ADs may permit remittance of assets on closure or remittance of winding up proceeds of branch office/ liaison office (other than project office) on submission of the following documents:

- (i) A copy of the Reserve Bank's permission for establishing the branch/ office in India.
- (ii) Auditor's certificate:
  - (a) indicating the manner in which the remittable amount has been arrived and supported by a statement of assets and liabilities of the applicant, and indicating the manner of disposal of assets;
  - (b) confirming that all liabilities in India including arrears of gratuity and other benefits to the employees etc., of the branch/ office have been either fully met or adequately provided for;

- (c) confirming that no income accruing from sources outside India (including proceeds of exports) has remained un-repatriated to India;
- (d) confirming that the branch/office has complied with all regulatory requirements stipulated by the Reserve Bank of India from time to time regarding functioning of such offices in India;
- (iii) a confirmation from the applicant that no legal proceedings are pending in any Court in India and there is no legal impediment to the remittance; and
- (iv) a report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 2013, in case of winding up of the office in India.

### Remittance of assets requiring RBI approval

Prior approval of the Reserve Bank is necessary for remittance of assets where:

- (a) Remittance is in excess of USD 1,000,000 (US Dollar One million only) per financial year
  - (i) on account of legacy, bequest or inheritance to a citizen of foreign state, resident outside India;
  - (ii) by NRIs/ PIOs out of the balances held in NRO accounts/ sale proceeds of assets/ the assets acquired by way of inheritance/ legacy.
- (b) Hardship will be caused to a person if remittance from India is not made to such a person.

Remittance of funds from the sale of assets in India held by a person, whether resident in or outside India, not covered under the directions stipulated above will require approval of the Reserve Bank.

### Income-tax clearance

The remittances are subject to payment of applicable taxes in India. Reserve Bank of India does not issue any instructions under FEMA clarifying tax issues. It is mandatory on the part of Authorised Dealers to comply with the requirement of tax laws, as applicable.

### Exemption from Realisation or Repatriation

Section 9 of the Act contains exemptions from the application of provisions relating to holding of foreign currency and realisation and repatriation in certain circumstances, as provided under Sections 4 and 8 of the Act respectively. Accordingly, possession of foreign currency or coins by any person or class of persons, as the Reserve Bank may specify is not prohibited. A person or class of persons may hold and operate foreign currency account within the prescribed limits as may be specified by the Reserve Bank. Foreign exchange acquired or received before 8th July, 1947, or any income arising or accruing thereon which is held outside India, in pursuance of a general or special permission of RBI, is also exempted.

Provisions relating to holding of foreign exchange, realisation and repatriation of foreign exchange are not applicable to person resident in India upto such limit as the Reserve Bank may specify, if such foreign exchange was acquired by way of gift or inheritance from certain persons mentioned above and any income arising there from. Reserve Bank may also specify the exemption limit upto which the foreign exchange earned by a person from employment, business, trade, vocation services, honorarium, gifts, inheritance or other legitimate means may be possessed. Reserve Bank may also exempt such other receipts as it thinks fit.

### POSSESSION AND RETENTION OF FOREIGN CURRENCY OR FOREIGN COINS

Foreign Exchange Management (Possession and Retention of Foreign Currency) Regulations, 2015 deals with limits on possession and retention of foreign currency or foreign coins. Under Regulation 3 the Reserve Bank has specified following limits for possession or retention of foreign currency or foreign coins, namely:

- (i) possession without limit of foreign currency and coins by an authorised person within the scope of his authority;
- (ii) possession without limit of foreign coins by any person;
- (iii) retention by a person resident in India of foreign currency notes, bank notes and foreign currency travelers cheques not exceeding US \$ 2000 or its equivalent in aggregate, provided that such foreign exchange in the

form of currency notes, bank notes and travelers cheques acquired during a visit to any place outside India by way of payment for services not arising from any business in or anything done in India; or from any person not resident in India and also who is on a visit to India, or as honorarium or gift or for services rendered or in settlement of any lawful obligation; or as a honorarium or gift while on a visit to any place outside India; or represents unspent amount of foreign exchange acquired from an authorised person for travel abroad.

Regulation 4 deals with possession of foreign exchange by a person resident in India but not permanently resident therein and provides that a person resident in India but not permanently resident therein may possess without limit foreign currency in the form of currency notes, bank notes and travelers cheques, if such foreign currency was acquired, held or owned by him when he was resident outside India and, has been brought into India in accordance with the law for the time being in force. Explanation to regulation 4 defines the term 'not permanently resident' as to mean a person resident in India for employment of a specified duration (irrespective of length thereof) or for a specific job or assignment, the duration of which does not exceed three years.

## AUTHORISED PERSON

Chapter III of the Act containing Sections 10-12 deals with the provisions relating to authorised person. Section 10 deals with the procedure of appointing authorised person by the Reserve Bank, Section 11 specifies the powers of the RBI to issue directions to authorised person and Section 12 prescribes the power of the RBI to inspect authorised person. An Authorised Dealer is any person specifically authorized by the Reserve Bank under Section 10(1) of FEMA, 1999, to deal in foreign exchange or foreign securities.

Under Section 10, any person who has made an application to the RBI may be authorised by it to act as an authorised person to deal in foreign exchange or in foreign securities as an authorised dealer, money changer or offshore banking unit or in any other manner as the RBI deem fit. This authorisation is in writing and subject to the conditions laid down by the RBI.

Normally, nationalised banks, leading non nationalized banks and foreign banks are appointed as authorized persons.

Authorised persons are required to comply with the directions of the Reserve Bank with regard to his dealing in foreign exchange or foreign security receipt with the previous permission of the Reserve Bank. However authorised person are required not to engage in any transaction involving any foreign exchange or foreign security which is not in conformity with the terms of his authorisation.

Reserve Bank of India has been empowered to revoke the authorisation granted to any person at any time in the public interest. It may also revoke the authorisation after giving an opportunity, if the authorised person failed to comply with the conditions subject to which the authorisation was granted or contravened any of the provisions of the Act, rules, notifications or directions.

An authorised person, before undertaking any transaction on behalf of any person shall, require that person to make such declaration and give such information as will reasonably satisfy the authorised person that the transaction will not involve or is not intended to violate or contravene any provisions of the Act, rules, notification or directions. In case, the person refuses to comply with such requirements or makes only unsatisfactory compliances, the authorised person is duty bound to refuse in writing to act on behalf of such person in such transaction and report the matter to Reserve Bank.

Any person, other than an authorised person who has acquired or purchased foreign exchange for any purpose mentioned in the declaration made by him to the authorised person does not use it for such purpose, or does not surrender it to authorised person within the specified period, or uses the foreign exchange for any other purpose, which is not permitted under the provisions of the Act, such person shall be deemed to have committed contravention of the provisions of the Act.

## Power of the Reserve Bank to issue directions to authorised person

Section 11 of the Act empowers the RBI to issue directions to the authorised person in regard to making of payment or doing or desist from doing any act relating to foreign exchange or foreign security. Reserve Bank has also been

empowered to issue directions to the authorised persons to furnish such information in such manner as it deems fit. If any authorised person contravenes any direction given by the RBI or fails to file the return as directed by RBI, he may be liable to a fine not exceeding Rs. 10,000/- and in the case of continuing contravention, with an additional penalty which may extend to Rs. 2,000 for every day during which such contravention continues. Power of Reserve Bank to Inspect authorised person

Section 12 of the Act empowers RBI to inspect the business of any authorised person for the purpose of verifying the correctness of any statement/information or particulars furnished. In case authorised person fails to furnish the information sought, the RBI can initiate inspection of the authorised person for obtaining such information. RBI may also inspect the business of an authorised person for securing compliance with the provisions of the Foreign Exchange Management Act or any of the Rules, Regulations or directions. The Reserve Bank may make an order in writing authorising any of its officer for this purpose.

When an inspection is initiated by the Reserve Bank, it shall be the duty of every authorised person (where the authorised person is a company or firm, every director partner or officer of such a company or firm), to produce before the inspecting officer, such books, accounts and other documents in his custody and to furnish any statement or information relating to the affairs of such authorised person within the time limit and the manner in which such inspecting officer may direct.

## ADJUDICATION AND APPEAL

Chapter V containing Sections 16-35 deals with the adjudication and appeal.

### Appointment of Adjudicating Authority

Section 16 empowers the Central Government to appoint by notification in the Official Gazette as many Adjudicating Authorities as it may think fit for holding enquiries under Section 13. The Central Government is, however under obligation to specify the jurisdiction of the Adjudicating Authority. The Adjudicating Authority has been empowered to hold any enquiry on a complaint made in writing by an officer authorised by a general or special order by the Central Government.

In case, a complaint has been made in respect of a person alleged to have committed the contravention, such person shall be given a reasonable opportunity of being heard before imposing any penalty under Section 13. The Adjudicating Authority has discretion to demand from the persons against whom a complaint is made a bond or guarantee for any such amount as he thinks fit, if he is of the opinion that such persons likely to abscond or evade the payment of penalty, if imposed.

### Appeal to Special Director (Appeals)

Section 17 of the Act provides for appointment of one or more Special Directors (Appeals) to hear appeals against the orders of the Adjudicating Authorities. In this context, the Central Government has been empowered to appoint by notification Special Directors (Appeals) specifying their jurisdiction over matters and places.

An appeal to the Special Director (Appeals) may be made against the orders of the Assistant Director or Deputy Director of enforcement, acting as Adjudicating Authority. The appeal against the order of Adjudicating Authority shall be made in the prescribed form along with requisite fee, within forty five days from the date of the receipt of the order by aggrieved person. The Special Director (Appeals) has however, been empowered to entertain appeal after the expiry of the said period of forty five days.

### Establishment of Appellate Tribunal

Section 18 of the Act provides that the Appellate Tribunal constituted under sub-section (1) of section 12(1) of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976, shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purposes of this Act and the said Appellate Tribunal shall exercise the jurisdiction, powers and authority conferred on it by or under this Act.

## Appeal to Appellate Tribunal

According to Section 19(1) the Central Government or any person aggrieved by an order made by an Adjudicating Authority, other than those referred to in section 17(1), or the Special Director (Appeals), may prefer an appeal to the Appellate Tribunal:

Provided that any person appealing against the order of the Adjudicating Authority or the Special Director (Appeals) levying any penalty, shall while filing the appeal, deposit the amount of such penalty with such authority as may be notified by the Central Government:

Provided further that where in any particular case, the Appellate Tribunal is of the opinion that the deposit of such penalty would cause undue hardship to such person, the Appellate Tribunal may dispense with such deposit subject to such conditions as it may deem fit to impose so as to safeguard the realisation of penalty.

Section 19 (2) states that every appeal under sub-section (1) shall be filed within a period of forty-five days from the date on which a copy of the order made by the Adjudicating Authority or the Special Director (Appeals) is received by the aggrieved person or by the Central Government and it shall be in such form, verified in such manner and be accompanied by such fee as may be prescribed:

Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of forty-five days if it is satisfied that there was sufficient cause for not filing it within that period.

As per Section 19(3), on receipt of an appeal under sub-section (1), the Appellate Tribunal may, after giving the parties to the appeal an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

Section 19(4) provides that the Appellate Tribunal shall send a copy of every order made by it to the parties to the appeal and to the concerned Adjudicating Authority or the Special Director (Appeals), as the case may be.

Section 19(5) states that the appeal filed before the Appellate Tribunal under sub-section (1) shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal finally within one hundred and eighty days from the date of receipt of the appeal:

Provided that where any appeal could not be disposed of within the said period of one hundred and eighty days, the Appellate Tribunal shall record its reasons in writing for not disposing off the appeal within the said period.

As per Section 19(6) the Appellate Tribunal may, for the purpose of examining the legality, propriety or correctness of any order made by the Adjudicating Authority under section 16 in relation to any proceeding, on its own motion or otherwise, call for the records of such proceedings and make such order in the case as it thinks fit.

## Appeal to High Court

According to Section 35 of the Act a right to appeal to High Court lies with the appellant who is aggrieved by the decision of the Tribunal. Such appeal must be filed within 60 days from the date of communication of the decision or order of the Tribunal. The appeal to the High Court can be made on any question of law arising out of such order. A relaxation for a maximum period of sixty days for making an appeal may be granted by the High Court, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the specified period.

## Directorate of Enforcement

Section 36 of the Act empowers the Central Government to establish a Directorate of Enforcement with a Director and other officers or class of Officers, for the purposes of the enforcement of the Act. The Central Government has also been empowered to authorise Director, Additional Director, Special Director or Deputy Director to appoint officers of enforcement below the rank of Assistant Director of Enforcement to exercise the powers and discharge the duties conferred or imposed on him under the Act.

The Central Government, may, by order and with prescribed conditions and limitations, authorise any officers of customs or Central Excise or any police officer or officers of Central or State Government to exercise such powers and discharge such duties of the Director of Enforcement or any other officer of the Enforcement as stated in the order.

## Investigation

Section 37 of the Act empowers the Director of Enforcement and other officers below the rank of Assistant Director to take up for investigation the contravention referred to in Section 13 of the Act. In addition, the Central Government may also authorise any officer or class of officers in the Central Government, State Government, Reserve Bank of India, not below the rank of Under Secretary to Government of India, to investigate any contravention under Section 13 of the Act. The officers so appointed shall exercise the like powers which are conferred on income tax authorities under the Income Tax Act, 1961, subject to such conditions and limitations as laid down under that Act.

## Contravention by Companies

Section 42 of the Act deals with contravention of the provisions of the Act by the Companies and provides that where the person committing the contravention of the Act or Rules happened to be a company, every person who at the time the contravention was committed, was in charge of and was responsible to the company for the conduct of the business of the company shall be deemed to be guilty of the contravention and liable to be proceeded against and punished accordingly. However, no such persons shall be deemed to be guilty of committing any offence if he proves that such contravention took place without his knowledge or that he exercised adequate steps to prevent such contravention.

In case the contravention is committed by a company and it is proved that such contravention is committed with the knowledge, consent and connivance or is attributed to the neglect on the part of any director, manager or secretary or other officer of the company, they will also be deemed to be guilty of contravention and liable to be proceeded against and punished accordingly.

## COMPOUNDING OF CONTRAVENTIONS

Contravention is a breach of the provisions of the Foreign Exchange Management Act (FEMA), 1999 and rules/regulations/notification/orders/directions/circulars issued there under. Compounding refers to the process of voluntarily admitting the contravention, pleading guilty and seeking redressal. The Reserve Bank is empowered to compound any contraventions as defined under section 13 of FEMA, 1999 except the contravention under section 3(a), for a specified sum after offering an opportunity of personal hearing to the contravener. It is a voluntary process in which an individual or a corporate seeks compounding of an admitted contravention. It provides comfort to any person who contravenes any provisions of FEMA, 1999 [except section 3(a) of the Act] by minimizing transaction costs. Willful, malafide and fraudulent transactions are, however, viewed seriously, which will not be compounded by the Reserve Bank.

Any person who contravenes any provision of the FEMA, 1999 [except section 3(a)] or contravenes any rule, regulation, notification, direction or order issued in exercise of the powers under this Act or contravenes any condition subject to which an authorization is issued by the Reserve Bank, can apply for compounding to the Reserve Bank. Applications seeking compounding of contraventions under section 3(a) of FEMA, 1999 may be submitted to the Directorate of Enforcement.

## Application for Compounding

- All applications for compounding may be submitted together with the prescribed fee by way of a demand draft drawn in favour of "Reserve Bank of India" and payable at the concerned Regional Office and by way of a demand draft drawn in favour of "Reserve Bank of India" and payable at Mumbai for cases submitted to the Compounding Authority, [Cell for Effective implementation of FEMA (CEFA)], Foreign Exchange Department, Reserve Bank of India, Central Office, Mumbai.
- Along with the application in the prescribed format, the applicant may also furnish the details relating to Foreign Direct Investment, External Commercial Borrowings, Overseas Direct Investment and Branch Office / Liaison Office, as applicable, a copy of the Memorandum of Association and latest audited balance sheet along with an undertaking that they are not under investigation of any agency such as DOE, CBI, etc. in order to complete the compounding process within the time frame.

- In case the application has to be returned where required approvals are not obtained from the authorities concerned or in case of incomplete application for any other reason, the application fees received along with the application will be returned by crediting the same to the applicant's account through NEFT as per the ECS mandate and details of their bank account as furnished along with the application. The application will be treated as incomplete without these details.
- The applicants are also advised to bring to the notice of the compounding authority change, if any, in the address/ contact details of the applicant during the pendency of the compounding application with Reserve Bank.

### Pre-requisite for Compounding Process

- In respect of a contravention committed by any person within a period of three years from the date on which a similar contravention committed by him was compounded under the Compounding Rules, such contraventions would not be compounded and relevant provisions of the FEMA, 1999 shall apply. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention.
- Contraventions relating to any transaction where proper approvals or permission from the Government or any statutory authority concerned, as the case may be, have not been obtained such contraventions would not be compounded unless the required approvals are obtained from the concerned authorities.
- Cases of contravention such as those having serious contravention suspected of money laundering, terror financing or affecting sovereignty and integrity of the nation or where the contravener fails to pay the sum for which contravention was compounded within the specified period in terms of the compounding order, shall be referred to the Directorate of Enforcement for further investigation and necessary action under FEMA, 1999 or to the authority instituted for implementation of the Prevention of Money Laundering Act 2002, or to any other agencies, for necessary action as deemed fit.
- In this connection, it is clarified that whenever a contravention is identified by the Reserve Bank or brought to its notice by the entity involved in contravention by way of a reference other than through the prescribed application for compounding, the Bank will continue to decide
  - » whether a contravention is technical and/or minor in nature and, as such, can be dealt with by way of an administrative/ cautionary advice;
  - » whether it is material and, hence, is required to be compounded for which the necessary compounding procedure has to be followed or
  - » whether the issues involved are sensitive / serious in nature and, therefore, need to be referred to the Directorate of Enforcement (DOE). However, once a compounding application is filed by the concerned entity *suo moto*, admitting the contravention, the same will not be considered as 'technical' or 'minor' in nature and the compounding process shall be initiated in terms of section 15 (1) of Foreign Exchange Management Act, 1999 read with Rule 9 of Foreign Exchange (Compounding Proceedings) Rules, 2000.

### Scope and Procedure for Compounding

- On receipt of the application for compounding, the Reserve Bank shall examine the application based on the documents and submissions made in the application and assess whether contravention is quantifiable and, if so, the amount of contravention.
- The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings. In case the contravener fails to submit the additional information/ documents called for within the specified period, the application for compounding will be liable for rejection.

The following factors, which are only indicative, may be taken into consideration for the purpose of passing compounding order and adjudging the quantum of sum on payment of which contravention shall be compounded:

- the amount of gain of unfair advantage, wherever quantifiable, made as a result of the contravention;
- the amount of loss caused to any authority/ agency/ exchequer as a result of the contravention;
- economic benefits accruing to the contravener from delayed compliance or compliance avoided;
- the repetitive nature of the contravention, the track record and/or history of non-compliance of the contravener;
- contravener's conduct in undertaking the transaction and in disclosure of full facts in the application and submissions made during the personal hearing; and any other factor as considered relevant and appropriate.

### **Issue of the Compounding Order**

The Compounding Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerned as expeditiously as possible as and not later than 180 days from the date of application on the basis of the averments made in the application as well as other documents and submissions made in this context by the contravener during the personal hearings.

The time limit for this purpose would be reckoned from the date of receipt of the completed application for compounding by the Reserve Bank.

If the applicant opts for appearing for the personal hearing, the Reserve Bank would encourage the applicant to appear directly for it rather than being represented / accompanied by legal experts / consultants, as compounding is only for admitted contraventions. Appearing for or opting out of personal hearing does not have any bearing whatsoever on the amount imposed in the compounding order. If the authorized representative of the applicant is unavailable for the personal hearing, the Compounding Authority may pass the order based on available information/ documents.

The Compounding Order shall specify the provisions of the FEMA, 1999 or any rule, regulation, notification, direction or order issued in exercise of the powers under FEMA, 1999 in respect of which contravention has taken place along with details of the contravention.

One copy of the compounding order issued under sub rule (2) of Rule 8 of Foreign Exchange (Compounding Proceedings) Rules, 2000 shall be supplied to the applicant (the contravener) and also to the Adjudicating Authority, where the compounding of any contravention is made after making of a complaint under sub-section (3) of section 16 of the FEMA, as the case may be.

To ensure more transparency and greater disclosure, it has been decided to host the compounding orders passed on the Reserve Bank's website ([www.rbi.org.in](http://www.rbi.org.in)).

### LESSON ROUND-UP

- Foreign exchange means 'foreign currency' and includes:- (i) deposits, credits and balances payable in any foreign currency; (ii) drafts, travellers' cheques, letters of credit or bills of exchange, expressed or drawn in Indian currency but payable in any foreign currency; and (iii) drafts, travellers' cheques, letters of credit or bills of exchange drawn by banks, institutions or persons outside India, but payable in Indian currency.
- Capital Account transactions means any transaction which alters the assets or liabilities including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of person resident outside India and includes the transactions specified in Sub-section (3) of Section 6 of the Act.
- Current Account Transaction means a transaction other than a capital account transaction and includes payments due in connection with foreign trade, other current business, services and short term banking and credit facilities in the ordinary course of business; payments due as interest on loan and as net income from investments; remittances for living expenses of parents, spouse and children residing abroad and expenses in connection with foreign travel, education and medical care of parents, spouse and children.
- In exercise of the powers conferred by Section 47 of the Foreign Exchange Management Act, the Reserve Bank issued the Foreign Exchange Management (Remittance of Assets) Regulations, 2016 in respect of remittance outside India by a person whether resident in India or not, of assets in India.
- Compounding refers to the process of voluntarily admitting the contravention, pleading guilty and seeking redressal. The Reserve Bank is empowered to compound any contraventions as defined under section 13 of FEMA, 1999 except the contravention under section 3(a) for a specified sum after offering an opportunity of personal hearing to the contravener. It is a voluntary process in which an individual or a corporate seeks compounding of an admitted contravention. It provides comfort to any person who contravenes any provisions of FEMA, 1999 [except section 3(a) of the Act] by minimizing transaction costs.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define the Capital Account Transactions and enumerate permissible capital account transactions in relation to persons resident in India and resident outside India?
2. Discuss the Acquisition and Transfer of Immovable Property outside India under FEMA?
3. Discuss the establishment of branch or office or place of business in India under FEMA.
4. Define Authorised person? Briefly discuss the powers of RBI to give directions to Authorised persons?
5. Write short notes on the following:
  - (i) Compounding of Contraventions
  - (ii) Current Account Transactions
  - (iii) Investigation

## Lesson 4

# The Foreign Contribution (Regulation) Act, 2010

### ***Key Concepts One Should Know***

- Foreign Contribution
- Foreign Source
- Foreign Hospitality
- Political Party

### ***Learning Objectives***

#### **To understand:**

- Regulation of Foreign contribution, Foreign Source and Foreign Hospitality
- Accounts, Intimation, Audit and Disposal of Assets
- Inspection, Search and Seizure

### ***Regulatory Framework***

- Foreign Contribution (Regulation) Act, 2010
- Foreign Contribution (Regulation) Rules, 2011

### ***Lesson Outline***

- Foreign contribution
- Regulation of foreign contribution and foreign hospitality
- Certificate of Registration
- Application for Renewal
- Renewal of Certificate
- Cancellation of Certificate
- Management of Foreign Contribution
- Intimation to Government
- Obligation of Banks under FCRA
- Inspection
- Offences and Penalties
- LESSON ROUND-UP
- TEST YOURSELF
- LIST OF FURTHER READINGS
- OTHER REFERENCES

## INTRODUCTION

The Foreign Contribution (Regulation) Act, 1976 was enacted to regulate the acceptance and utilization of foreign contribution or hospitality with a view to ensuring that the Parliamentary institutions, political associations, academic and other voluntary organizations as well as individuals working in important areas of national life may function in a manner consistent with the values of sovereign democratic republic. The Act was amended in the year 1984 to extend its provisions to cover second and subsequent recipients of foreign contribution and to the members of higher judiciary, besides introducing the system of grant of registration to the association receiving foreign contribution.

Significant development have taken place since 1984 such as change in internal security scenario, an increased influence of voluntary organizations, spread of use of communication and information technology, quantum jump in the amount of foreign contribution being received, and large scale growth in the number of registered organizations. This has necessitated large scale changes in the Act of 1976 and therefore, it was thought appropriate to replace the FCRA, 1976 by a new legislation Foreign Contribution (Regulation) Act, 2010 to regulate the acceptance and utilization of foreign contribution and foreign hospitality by a person or association.

The Foreign Contribution (Regulation) Act, 2010 has come into effect from May 1, 2011. The Ministry of Home Affairs had issued the necessary Gazette Notification vide S.O. 999 (E) dated the 29th April, 2011 in this regard. The Ministry of Home Affairs also issued a Gazette Notification vide G.S.R. 349 (E) dated the 29th April, 2011 notifying the Foreign Contribution (Regulation) Rules, 2011 made under section 48 of FCRA, 2010. The FCR Rules, 2011 have come into force simultaneously with FCRA, 2010.

The Foreign Contribution (Regulation) Act, 2010 was enacted to regulate the acceptance and utilisation of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the national interest and for matters connected therewith or incidental thereto.

Further, in order to streamline the provisions of the Foreign Contribution (Regulation) Act, 2010 by strengthening the compliance mechanism, enhancing transparency and accountability in the receipt and utilisation of foreign contribution worth thousands of crores of rupees every year and facilitating genuine non-Governmental organisations or associations who are working for the welfare of the society, Parliament enacted the Foreign Contribution (Regulation) Amendment Act, 2020.

***The salient features of the Foreign Contribution (Regulation) Amendment Act, 2020 inter alia, are as under:—***

- (a) Amended Section 3(1) (c) of the Act to include “public servant” also within its ambit, to provide that no foreign contribution shall be accepted by any public servant;
- (b) Amended Section 7 of the Act to prohibit any transfer of foreign contribution to any association/ person.
- (c) Amended section 8(1) of the Act to reduce the limit for defraying administrative expenses from existing “fifty per cent.” to “twenty per cent.”
- (d) Inserted of a new Section 12A empowering the Central Government to require Aadhaar number, etc., as identification document;
- (e) Inserted of a new Section 14A enabling the Central Government to permit any person to surrender the certificate granted under the Act;
- (f) Amended Section 17 of the Act to provide that every person who has been granted certificate or prior permission under section 12 shall receive foreign contribution only in an account designated as “FCRA Account” which shall be opened by him in such branch of the State Bank of India at New Delhi, as the Central Government may, by notification, specify and for other consequential matters relating thereto.

## DEFINITIONS

The definitions of the following terms used in the statute are relevant for understanding the operative provisions of the Foreign Contribution (Regulation) Act, 2010.

**"Association"** means an association of individuals, whether incorporated or not, having an office in India and includes a society, whether registered under the Societies Registration Act, 1860 (21 of 1860), or not, and any other organisation, by whatever name called. [Section 2(a)]

**"Authorised Person in Foreign Exchange"** means an authorised person referred to in clause (c) of section 2 of the Foreign Exchange Management Act, 1999. [Section 2(b)]

**"Bank"** means a banking company as referred to in clause (c) of section 5 of the Banking Regulation Act, 1949. [Section 2(c)]

**"Candidate for Election"** means a person who has been duly nominated as a candidate for election to any Legislature. [Section 2(d)]

**"Certificate"** means certificate of registration granted under sub-section (3) of section 12. [Section 2(e)]

**"Company"** shall have the meaning assigned to it under clause (17) of section 2 of the Income-tax Act, 1961. [Section 2(f)]

**"Foreign Company"** means any company or association or body of individuals incorporated outside India and includes—

- (i) a foreign company within the meaning of section 591 of the Companies Act, 1956 ;
- (ii) a company which is a subsidiary of a foreign company;
- (iii) the registered office or principal place of business of a foreign company referred to in sub-clause (i) or company referred to in sub-clause (ii);
- (iv) a multi-national corporation.

*Explanation.*—For the purposes of this sub-clause, a corporation incorporated in a foreign country or territory shall be deemed to be a multi-national corporation if such corporation,—

- (a) has a subsidiary or a branch or a place of business in two or more countries or territories; or
- (b) carries on business, or otherwise operates, in two or more countries or territories. [Section 2(g)]

**"Foreign Contribution"** means the donation, delivery or transfer made by any foreign source,—

- (i) of any article, not being an article given to a person as a gift for his personal use, if the market value, in India, of such article, on the date of such gift, is not more than such sum as may be specified from time to time, by the Central Government by the rules made by it in this behalf;
- (ii) of any currency, whether Indian or foreign;
- (iii) of any security as defined in clause (h) of section 2 of the Securities Contracts (Regulation) Act, 1956 and includes any foreign security as defined in clause (o) of section 2 of the Foreign Exchange Management Act, 1999 .

*Explanation 1.*—A donation, delivery or transfer of any article, currency or foreign security referred to in this clause by any person who has received it from any foreign source, either directly or through one or more persons, shall also be deemed to be foreign contribution within the meaning of this clause.

*Explanation 2.*—The interest accrued on the foreign contribution deposited in any bank referred to in sub-section (1) of section 17 or any other income derived from the foreign contribution or interest thereon shall also be deemed to be foreign contribution within the meaning of this clause.

*Explanation 3.*—Any amount received, by any person from any foreign source in India, by way of fee (including fees charged by an educational institution in India from foreign student) or towards cost in lieu of goods or services

rendered by such person in the ordinary course of his business, trade or commerce whether within India or outside India or any contribution received from an agent of a foreign source towards such fee or cost shall be excluded from the definition of foreign contribution within the meaning of this clause .[Section 2(h)]

**"Foreign Hospitality"** means any offer, not being a purely casual one, made in cash or kind by a foreign source for providing a person with the costs of travel to any foreign country or territory or with free boarding, lodging, transport or medical treatment.[Section 2(i)]

**"Foreign Source"** includes,—

- (i) the Government of any foreign country or territory and any agency of such Government;
- (ii) any international agency, not being the United Nations or any of its specialised agencies, the World Bank, International Monetary Fund or such other agency as the Central Government may, by notification, specify in this behalf;
- (iii) a foreign company;
- (iv) a corporation, not being a foreign company, incorporated in a foreign country or territory;
- (v) a multi-national corporation referred to in sub-clause (iv) of clause (g);
- (vi) a company within the meaning of the Companies Act, 1956 , and more than one-half of the nominal value of its share capital is held, either singly or in the aggregate, by one or more of the following, namely:—
  - (a) the Government of a foreign country or territory;
  - (b) the citizens of a foreign country or territory;
  - (c) corporations incorporated in a foreign country or territory;
  - (d) trusts, societies or other associations of individuals (whether incorporated or not), formed or registered in a foreign country or territory;
- (vii) foreign company;
- (viii) a trade union in any foreign country or territory, whether or not registered in such foreign country or territory;
- (ix) a foreign trust or a foreign foundation, by whatever name called, or such trust or foundation mainly financed by a foreign country or territory;
- (x) a society, club or other association of individuals formed or registered outside India;
- (xi) a citizen of a foreign country.[Section 2(j)]

**"Legislature"** means—

- (a) either House of Parliament;
- (b) the Legislative Assembly of a State, or in the case of a State having a Legislative Council, either House of the Legislature of that State;
- (c) Legislative Assembly of a Union territory constituted under the Government of Union Territories Act, 1963;
- (d) Legislative Assembly for the National Capital Territory of Delhi referred to in the Government of National Capital Territory of Delhi Act, 1991 ;
- (e) Municipality as defined in clause (e) of article 243P of the Constitution;
- (f) District Councils and Regional Councils in the States of Assam, Meghalaya, Tripura and Mizoram as provided in the Sixth Schedule to the Constitution;
- (g) Panchayat as defined in clause (d) of article 243 of the Constitution; or
- (h) any other elective body as may be notified by the Central Government; .[Section 2(k)]

**"Notification"** means notification published in the Official Gazette and the expression "notify" shall be construed accordingly.[Section 2(l)]

**"Person"** includes—

- (i) an individual;
- (ii) a Hindu undivided family;
- (iii) an association;
- (iv) a company registered under section 25 of the Companies Act, 1956.[Section 2(m)]

**"Political Party"** means—

- (i) an association or body of individual citizens of India—
  - (a) to be registered with the Election Commission of India as a political party under section 29A of the Representation of the People Act, 1951; or
  - (b) which has set up candidates for election to any Legislature, but is not so registered or deemed to be registered under the Election Symbols (Reservation and Allotment) Order, 1968;
- (ii) a political party mentioned in column 2 of Table 1 and Table 2 to the notification of the Election Commission of India No. 56/J&K/02, dated the 8th August, 2002, as in force for the time being.[Section 2(n)]

**"Prescribed"** means prescribed by rules made under this Act. [Section 2(o)]

**"Prescribed Authority"** means an authority specified as such by rules made by the Central Government under this Act. [Section 2(p)]

**"Registered Newspaper"** means a newspaper registered under the Press and Registration of Books Act, 1867. [Section 2(q)]

**"Relative"** has the meaning assigned to it in clause (41) of section 2 of the Companies Act, 1956. [Section 2(r)]

**"Scheduled Bank"** shall have the meaning assigned to it under clause (e) of section 2 of the Reserve Bank of India Act, 1934. [Section 2(s)]

**"Subsidiary" and "Associate"** shall have the meanings, respectively assigned to them in the Companies Act, 1956. [Section 2(t)]

**"Trade Union"** means a trade union registered under the Trade Unions Act, 1926. [Section 2(u)]

According to Section 2(2) of the Act, words and expressions used herein and not defined in this Act but defined in the Representation of the People Act, 1950 or the Representation of the People Act, 1951 or the Foreign Exchange Management Act, 1999 shall have the meanings respectively assigned to them in those Acts.

## REGULATION OF FOREIGN CONTRIBUTION AND FOREIGN HOSPITALITY

### Prohibition to Accept Foreign Contribution

Section 3(1) prohibits following person to accept foreign contribution:

- (a) candidate for election;
- (b) correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper;
- (c) public servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;
- (d) member of any Legislature;
- (e) political party or office-bearer thereof;
- (f) organisation of a political nature as may be specified under section 5(1) by the Central Government;
- (g) association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any electronic mode, or any other electronic form as defined in section 2(1)(r) of the Information Technology Act, 2000 or any other mode of mass communication;

(h) correspondent or columnist, cartoonist, editor, owner of the association or company referred to in clause (g).

Explanation.1—For the purpose of clause (c), “public servant” means a public servant as defined in section 21 of the Indian Penal Code .

Explanation 2.—In clause (c) and section 6, the expression “corporation” means a corporation owned or controlled by the Government and includes a Government company as defined in clause (45) of section 2 of the Companies Act, 2013.

Section 3(2) states that:

- (a) No person, resident in India, and no citizen of India resident outside India, shall accept any foreign contribution, or acquire or agree to acquire any currency from a foreign source, on behalf of any political party, or any person referred to in sub-section (1), or both.
- (b) No person, resident in India, shall deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to any person if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to any political party or any person referred to in sub-section (1), or both.
- (c) No citizen of India resident outside India shall deliver any currency, whether Indian or foreign, which has been accepted from any foreign source, to—
  - (i) any political party or any person referred to in sub-section (1), or both; or
  - (ii) any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a political party or to any person referred to in sub-section (1), or both.

According to Section 3(3) of the Act, no person receiving any currency, whether Indian or foreign, from a foreign source on behalf of any person or class of persons, referred to in section 9, shall deliver such currency—

- (a) to any person other than a person for which it was received, or
- (b) to any other person, if he knows or has reasonable cause to believe that such other person intends, or is likely, to deliver such currency to a person other than the person for which such currency was received.

### Persons to Whom Section 3 Shall Not Apply

According to Section 4 of the Act, nothing contained in section 3 shall apply to the acceptance, by any person specified in that section, of any foreign contribution where such contribution is accepted by him, subject to the provisions of section 10,—

- (a) by way of salary, wages or other remuneration due to him or to any group of persons working under him, from any foreign source or by way of payment in the ordinary course of business transacted in India by such foreign source; or
- (b) by way of payment, in the course of international trade or commerce, or in the ordinary course of business transacted by him outside India; or
- (c) as an agent of a foreign source in relation to any transaction made by such foreign source with the Central Government or State Government; or
- (d) by way of a gift or presentation made to him as a member of any Indian delegation, provided that such gift or present was accepted in accordance with the rules made by the Central Government with regard to the acceptance or retention of such gift or presentation; or
- (e) from his relative; or
- (f) by way of remittance received, in the ordinary course of business through any official channel, post office, or any authorised person in foreign exchange under the Foreign Exchange Management Act, 1999; or
- (g) by way of any scholarship, stipend or any payment of like nature:

it may be noted that in case any foreign contribution received by any person specified under section 3, for any of the purposes other than those specified under this section, such contribution shall be deemed to have been accepted in contravention of the provisions of section 3.

#### *Who cannot receive foreign contribution?*

*Answer:*

As defined in Section 3(1) of FCRA, 2010, the following are prohibited to receive foreign contribution:

- Candidate for election;
- Correspondent, columnist, cartoonist, editor, owner, printer or publisher of a registered newspaper;
- Public Servant, Judge, Government servant or employee of any corporation or any other body controlled or owned by the Government;
- Member of any legislature;
- Political party or office bearer thereof;
- Organization of a political nature as may be specified under sub-section (1) of Section 5 by the Central Government.
- Association or company engaged in the production or broadcast of audio news or audio visual news or current affairs programmes through any electronic mode, or any other electronic form as defined in clause (r) of sub-section (1) of Section 2 of the Information Technology Act, 2000 or any other mode of mass communication;
- Correspondent or columnist, cartoonist, editor, owner of the association or company referred to in above point.
- Individuals or associations who have been prohibited from receiving foreign contribution.

#### **Procedure to Notify an Organisation of a Political Nature**

According to Section 5(1) the Central Government may, having regard to the activities of the organisation or the ideology propagated by the organisation or the programme of the organisation or the association of the organisations with the activities of any political party, by an order published in the Official Gazette, specify such organisation as an organisation of a political nature not being a political party, referred to in clause (f) of sub-section (1) of section 3. The Central Government may, by rules made by it, frame the guidelines specifying the ground or grounds on which an organisation shall be specified as an organisation of a political nature.

As per Section 5(2) of the Act, before making an order under sub-section (1), the Central Government shall give the organisation in respect of whom the order is proposed to be made, a notice in writing informing it of the ground or grounds, on which it is proposed to be specified as an organisation of political nature under that sub-section.

Section 5(3) states that the organisation to whom a notice has been served under sub-section (2), may, within a period of thirty days from the date of the notice, make a representation to the Central Government giving reasons for not specifying such organisation as an organisation under sub-section (1). The Central Government may entertain the representation after the expiry of the said period of thirty days, if it is satisfied that the organisation was prevented by sufficient cause from making the representation within thirty days.

Section 5(4) provides that the Central Government may, if it considers it appropriate, forward the representation referred to in sub-section (3) to any authority to report on such representation.

The Central Government may, after considering the representation and the report of the authority referred to in sub-section (4), specify such organisation as an organisation of a political nature not being a political party and make an order under sub-section (1) accordingly.

Every order under sub-section (1) shall be made within a period of one hundred and twenty days from the date of issue of notice under sub-section (2). In case no order is made within the said period of one hundred and twenty days, the Central Government shall, after recording the reasons therefor, make an order under sub-section (1) within a period of sixty days from the expiry of the said period of one hundred and twenty days.

### Who can receive foreign contribution?

*Answer:*

*Any "Person" can receive foreign contribution subject to the following conditions:-*

- It must have a definite cultural, economic, educational, religious or social programme.
- It must obtain the FCRA registration/prior permission from the Central Government
- It must not be prohibited under Section 3 of FCRA, 2010.

### Restriction on Acceptance of Foreign Hospitality

According to Section 6 of the Act, no member of a Legislature or office-bearer of a political party or Judge or Government servant or employee of any corporation or any other body owned or controlled by the Government shall, while visiting any country or territory outside India, accept, except with the prior permission of the Central Government, any foreign hospitality.

Provided that it shall not be necessary to obtain any such permission for an emergent medical aid needed on account of sudden illness contracted during a visit outside India, but, where such foreign hospitality has been received, the person receiving such hospitality shall give, within one month from the date of receipt of such hospitality an intimation to the Central Government as to the receipt of such hospitality, and the source from which, and the manner in which, such hospitality was received by him.

### What is foreign hospitality?

*Answer:*

Foreign Hospitality means any offer, not being a purely casual one, made in cash or kind by a foreign source for providing a person with the costs of travel to any foreign country or territory or with free board, lodging, transport or medical treatment.

*State the categories of persons requires prior approval from Ministry of Home Affairs before accepting Foreign Hospitality?*

*Answer:*

The following categories of persons require prior approval from Ministry of Home Affairs before accepting Foreign Hospitality:-

- Members of a Legislature
- Office bearers of political parties
- Judges
- Government servants, Public Servants
- Employees of any corporation or any other body owned or controlled by the Government.

Provided that it shall not be necessary to obtain any such permission for an emergent medical aide needed on account of sudden illness contracted during a visit outside India. But, where such foreign hospitality has been received, the person receiving such hospitality shall give an intimation to the Central Government as to the receipt of such hospitality within one month from the date of receipt of such hospitality, and the source from which, and the manner in which, such hospitality was received.

## Prohibition to Transfer Foreign Contribution to Other Person

Section 7 of the provides that person who

- (a) is registered and granted a certificate or has obtained prior permission under the Act; and
- (b) receives any foreign contribution,

shall not transfer such foreign contribution to any other person.

## Restriction to Utilise Foreign Contribution for Administrative Purpose

According to Section 8 of the Act, every person, who is registered and granted a certificate or given prior permission under the Act and receives any foreign contribution,—

- (a) shall utilise such contribution for the purposes for which the contribution has been received:  
Provided that any foreign contribution or any income arising out of it shall not be used for speculative business:  
Provided further that the Central Government shall, by rules, specify the activities or business which shall be construed as speculative business for the purpose of this section;
- (b) shall not defray as far as possible such sum, ***not exceeding twenty per cent.*** of such contribution, received in a financial year, to meet administrative expenses:

Provided that administrative expenses exceeding twenty per cent. of such contribution may be defrayed with prior approval of the Central Government.

The Central Government may prescribe the elements which shall be included in the administrative expenses and the manner in which the administrative expenses shall be calculated.

## Power of Central Government to Prohibit Receipt of Foreign Contribution, etc., in Certain Cases

According to Section 9 of the Act, the Central Government may—

- (a) prohibit any person or organisation not specified in section 3, from accepting any foreign contribution;
- (b) require any person or class of persons, not specified in section 6, to obtain prior permission of the Central Government before accepting any foreign hospitality;
- (c) require any person or class of persons not specified in section 11, to furnish intimation within such time and in such manner as may be prescribed as to the amount of any foreign contribution received by such person or class of persons as the case may be, and the source from which and the manner in which such contribution was received and the purpose for which and the manner in which such foreign contribution was utilised;
- (d) without prejudice to the provisions of sub-section (1) of section 11, require any person or class of persons specified in that sub-section to obtain prior permission of the Central Government before accepting any foreign contribution;
- (e) require any person or class of persons, not specified in section 6, to furnish intimation, within such time and in such manner as may be prescribed, as to the receipt of any foreign hospitality, the source from which and the manner in which such hospitality was received:

Provided that no such prohibition or requirement shall be made unless the Central Government is satisfied that the acceptance of foreign contribution by such person or class of persons, as the case may be, or the acceptance of foreign hospitality by such person, is likely to affect prejudicially—

- (i) the sovereignty and integrity of India; or
- (ii) public interest; or
- (iii) freedom or fairness of election to any Legislature; or
- (iv) friendly relations with any foreign State; or
- (v) harmony between religious, racial, social, linguistic or regional groups, castes or communities.

## Power to Prohibit Payment of Currency Received in Contravention of the Act

Section 10 provides that where the Central Government is satisfied, after making such inquiry as it may deem fit, that any person has in his custody or control any article or currency or security, whether Indian or foreign, which has been accepted by such person in contravention of any of the provisions of this Act, it may, by order in writing, prohibit such person from paying, delivering, transferring or otherwise dealing with, in any manner whatsoever, such article or currency or security save in accordance with the written orders of the Central Government and a copy of such order shall be served upon the person so prohibited in the prescribed manner, and thereupon the provisions of sub-sections (2), (3), (4) and (5) of section 7 of the Unlawful Activities (Prevention) Act, 1967 shall, so far as may be, apply to, or in relation to, such article or currency or security and references in the said sub-sections to moneys, securities or credits shall be construed as references to such article or currency or security.

## REGISTRATION

### Registration of Certain Persons with Central Government

Section 11(1) provides that save as otherwise provided in this Act, no person having a definite cultural, economic, educational, religious or social programme shall accept foreign contribution unless such person obtains a certificate of registration from the Central Government:

It may be noted any association registered with the Central Government under section 6 or granted prior permission under that section of the Foreign Contribution (Regulation) Act, 1976, as it stood immediately before the commencement of this Act, shall be deemed to have been registered or granted prior permission, as the case may be, under this Act and such registration shall be valid for a period of five years from the date on which this section comes into force.

Section 11(2) states that every person referred to in sub-section (1) may, if it is not registered with the Central Government under that sub-section, accept any foreign contribution only after obtaining the prior permission of the Central Government and such prior permission shall be valid for the specific purpose for which it is obtained and from the specific source:

However, the Central Government, on the basis of any information or report, and after holding a summary inquiry, has reason to believe that a person who has been granted prior permission has contravened any of the provisions of this Act, it may, pending any further inquiry, direct that such person shall not utilise the unutilised foreign contribution or receive the remaining portion of foreign contribution which has not been received or, as the case may be, any additional foreign contribution, without prior approval of the Central Government:

Provided further that if the person referred to in sub-section (1) or sub-section (2) has been found guilty of violation of any of the provisions of the Act or the Foreign Contribution (Regulation) Act, 1976, the unutilised or unreceived amount of foreign contribution shall not be utilised or received, as the case may be, without the prior approval of the Central Government.

According to Section 11(3) of the Act, notwithstanding anything contained in the Act, the Central Government may, by notification in the Official Gazette, specify—

- (i) the person or class of persons who shall obtain its prior permission before accepting the foreign contribution; or
- (ii) the area or areas in which the foreign contribution shall be accepted and utilised with the prior permission of the Central Government; or
- (iii) the purpose or purposes for which the foreign contribution shall be utilised with the prior permission of the Central Government; or
- (iv) the source or sources from which the foreign contribution shall be accepted with the prior permission of the Central Government.

## Grant of Certificate of Registration

According to Section 12 of the Act:

- (1) An application by a person, referred to in section 11 for grant of certificate or giving prior permission, shall be made to the Central Government in such form and manner and along with such fee, as may be prescribed.
- (1A) Every person who makes an application under sub-section (1) shall be required to open "FCRA Account" in the manner specified in section 17 and mention details of such account in his application.
- (2) On receipt of an application under sub-section (1), the Central Government shall, by an order, if the application is not in the prescribed form or does not contain any of the particulars specified in that form, reject the application.
- (3) If on receipt of an application for grant of certificate or giving prior permission and after making such inquiry as the Central Government deems fit, it is of the opinion that the conditions specified in sub-section (4) are satisfied, it may, ordinarily within ninety days from the date of receipt of application under sub-section (1), register such person and grant him a certificate or give him prior permission, as the case may be, subject to such terms and conditions as may be prescribed.

Provided that in case the Central Government does not grant, within the said period of ninety days, a certificate or give prior permission, it shall communicate the reasons therefor to the applicant:

Provided further that a person shall not be eligible for grant of certificate or giving prior permission, if his certificate has been suspended and such suspension of certificate continues on the date of making application.

- (4) The following shall be the conditions for the purposes of sub-section (3), namely:—
  - (a) the person making an application for registration or grant of prior permission under sub-section (1),—
    - (i) is not fictitious or benami;
    - (ii) has not been prosecuted or convicted for indulging in activities aimed at conversion through inducement or force, either directly or indirectly, from one religious faith to another;
    - (iii) has not been prosecuted or convicted for creating communal tension or disharmony in any specified district or any other part of the country;
    - (iv) has not been found guilty of diversion or mis-utilisation of its funds;
    - (v) is not engaged or likely to engage in propagation of sedition or advocate violent methods to achieve its ends;
    - (vi) is not likely to use the foreign contribution for personal gains or divert it for undesirable purposes;
    - (vii) has not contravened any of the provisions of this Act;
  - (b) the person making an application for registration under sub-section (1) has undertaken reasonable activity in its chosen field for the benefit of the society for which the foreign contribution is proposed to be utilised;
  - (c) the person making an application for giving prior permission under sub-section (1) has prepared a reasonable project for the benefit of the society for which the foreign contribution is proposed to be utilised;
  - (d) in case the person being an individual, such individual has neither been convicted under any law for the time being in force nor any prosecution for any offence pending against him;
  - (e) in case the person being other than an individual, any of its directors or office bearers has neither been convicted under any law for the time being in force nor any prosecution for any offence is pending against him;
  - (f) the acceptance of foreign contribution by the person referred to in sub-section (1) is not likely to affect prejudicially—
    - (i) the sovereignty and integrity of India; or

- (ii) the security, strategic, scientific or economic interest of the State; or
  - (iii) the public interest; or (iv) freedom or fairness of election to any Legislature; or
  - (iv) friendly relation with any foreign State; or
  - (v) harmony between religious, racial, social, linguistic, regional groups, castes or communities;
  - (g) the acceptance of foreign contribution referred to in sub-section (1),—
    - (i) shall not lead to incitement of an offence;
    - (ii) shall not endanger the life or physical safety of any person.
- (5) Where the Central Government refuses the grant of certificate or does not give prior permission, it shall record in its order the reasons therefor and furnish a copy thereof to the applicant.
- Provided that the Central Government may not communicate the reasons for refusal for grant of certificate or for not giving prior permission to the applicant under this section in cases where there is no obligation to give any information or documents or records or papers under the Right to Information Act, 2005 (22 of 2005).
- (6) The certificate granted under sub-section (3) shall be valid for a period of **five years** and the prior permission shall be valid for the specific purpose or specific amount of foreign contribution proposed to be received, as the case may be.

### **Power of Central Government to require Aadhaar number, etc., as identification document**

Section 12A provides that notwithstanding anything contained in the Act, the Central Government may require that any person who seeks prior permission or prior approval under section 11, or makes an application for grant of certificate under section 12, or, as the case may be, for renewal of certificate under section 16, shall provide as identification document, the Aadhaar number of all its office bearers or Directors or other key functionaries, by whatever name called, issued under the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016, or a copy of the Passport or Overseas Citizen of India Card, in case of a foreigner.

### **Suspension of Certificate**

According to Section 13 of the Act, where the Central Government, for reasons to be recorded in writing, is satisfied that pending consideration of the question of cancelling the certificate on any of the grounds mentioned in section 14(1), it is necessary so to do, it may, by order in writing, suspend the certificate for a period of one hundred and eighty days, or such further period, not exceeding one hundred and eighty days, as may be specified in the order.

Every person whose certificate has been suspended shall not receive any foreign contribution during the period of suspension of certificate.

It may be noted that the Central Government, on an application made by such person, if it considers appropriate, allow receipt of any foreign contribution by such person on such terms and conditions as it may specify;

Every person whose certificate has been suspended shall utilise, in the prescribed manner, the foreign contribution in his custody with the prior approval of the Central Government.

### **Cancellation of Certificate**

Section 14 provides that the Central Government may, if it is satisfied after making such inquiry as it may deem fit, by an order, cancel the certificate if—

1. the holder of the certificate has made a statement in, or in relation to, the application for the grant of registration or renewal thereof, which is incorrect or false; or
  - (i) the holder of the certificate has violated any of the terms and conditions of the certificate or renewal thereof; or
  - (ii) in the opinion of the Central Government, it is necessary in the public interest to cancel the certificate; or
  - (iii) the holder of certificate has violated any of the provisions of this Act or rules or order made thereunder; or

- (iv) if the holder of the certificate has not been engaged in any reasonable activity in its chosen field for the benefit of the society for two consecutive years or has become defunct.
- (2) No order of cancellation of certificate under this section shall be made unless the person concerned has been given a reasonable opportunity of being heard.
- (3) Any person whose certificate has been cancelled under this section shall not be eligible for registration or grant of prior permission for a period of three years from the date of cancellation of such certificate.

### **Surrender of Certificate**

Section 14A states that on a request being made in this behalf, the Central Government may permit any person to surrender the certificate granted under this Act, if, after making such inquiry as it deems fit, it is satisfied that such person has not contravened any of the provisions of this Act, and the management of foreign contribution and asset, if any, created out of such contribution has been vested in the authority as provided in section 15(1).

### **Management of Foreign Contribution of Person Whose Certificate has been Cancelled or Surrendered**

Section 15(1) of the Act provides that the foreign contribution and assets created out of the foreign contribution in the custody of every person whose certificate has been cancelled under section 14 or surrendered under section 14A shall vest in such authority as may be prescribed.

The authority referred to in section 15 (1) above may, if it considers necessary and in public interest, manage the activities of the person referred to in that sub-section for such period and in such manner, as the Central Government may direct and such authority may utilise the foreign contribution or dispose of the assets created out of it in case adequate funds are not available for running such activity.

The authority referred to in section 15(1) shall return the foreign contribution and the assets vested upon it under that sub-section to the person referred to in the said sub-section if such person is subsequently registered under this Act.

### **Renewal of Certificate**

Section 16 of the Act provides that every person who has been granted a certificate under section 12 shall have such certificate renewed within six months before the expiry of the period of the certificate.

It may be noted that that the Central Government may, before renewing the certificate, make such inquiry, as it deems fit, to satisfy itself that such person has fulfilled all conditions specified in section 12(4).

The application for renewal of the certificate shall be made to the Central Government in such form and manner and accompanied by such fee as may be prescribed.

The Central Government shall renew the certificate, ordinarily within ninety days from the date of receipt of application for renewal of certificate subject to such terms and conditions as it may deem fit and grant a certificate of renewal for a period of five years:

In case the Central Government does not renew the certificate within the said period of ninety days, it shall communicate the reasons therefor to the applicant.

The Central Government may refuse to renew the certificate in case where a person has violated any of the provisions of this Act or rules made thereunder.

### **ACCOUNTS, INTIMATION, AUDIT AND DISPOSAL OF ASSETS, ETC.**

#### **Foreign Contribution through Scheduled Bank**

According to Section 17(1) of the Act every person who has been granted certificate or prior permission under section 12 shall receive foreign contribution only in an account designated as "FCRA Account" by the bank, which shall be opened by him for the purpose of remittances of foreign contribution in such branch of the State Bank of India at New Delhi, as the Central Government may, by notification, specify in this behalf.

Provided that such person may also open another “FCRA Account” in any of the scheduled bank of his choice for the purpose of keeping or utilising the foreign contribution which has been received from his “FCRA Account” in the specified branch of State Bank of India at New Delhi:

Provided further that such person may also open one or more accounts in one or more scheduled banks of his choice to which he may transfer for utilising any foreign contribution received by him in his “FCRA Account” in the specified branch of the State Bank of India at New Delhi or kept by him in another “FCRA Account” in a scheduled bank of his choice:

Provided also that no funds other than foreign contribution shall be received or deposited in any such account.

to Section 17 (2) states that the specified branch of the State Bank of India at New Delhi or the branch of the scheduled bank where the person referred to in sub-section (1) has opened his foreign contribution account or the authorised person in foreign exchange, shall report to such authority as may be specified,—

- (a) the prescribed amount of foreign remittance;
- (b) the source and manner in which the foreign remittance was received; and
- (c) other particulars,
- (d) in such form and manner as may be prescribed.

### **Intimation**

Section 18 of the Act provides that every person who has been granted a certificate or given prior approval under this Act shall give, within such time and in such manner as may be prescribed, an intimation to the Central Government, and such other authority as may be specified by the Central Government, as to the amount of each foreign contribution received by it, the source from which and the manner in which such foreign contribution was received, and the purposes for which, and the manner in which such foreign contribution was utilised by him.

Every person receiving foreign contribution shall submit a copy of a statement indicating therein the particulars of foreign contribution received duly certified by officer of the bank or authorised person in foreign exchange and furnish the same to the Central Government along with the intimation above.

### **Maintenance of Accounts**

According to Section 19, every person who has been granted a certificate or given prior approval under this Act shall maintain, in such form and manner as may be prescribed,—

- (a) an account of any foreign contribution received by him; and
- (b) a record as to the manner in which such contribution has been utilised by him.

### **Audit of Accounts**

Section 20 provides that where any person who has been granted a certificate or given prior permission, fails to furnish any intimation under this Act within the time specified therefor or the intimation so furnished is not in accordance with law or if, after inspection of such intimation, the Central Government has any reasonable cause to believe that any provision of this Act has been, or is being, contravened, the Central Government may, by general or special order, authorise such gazette officer, holding a Group A post under the Central Government or any other officer or authority or organisation, as it may think fit, to audit any books of account kept or maintained by such person and thereupon every such officer shall have the right to enter in or upon any premises at any reasonable hour, before sunset and after sunrise, for the purpose of auditing the said books of account.

It may be noted that any information obtained from such audit shall be kept confidential and shall not be disclosed except for the purposes of this Act.

### **Intimation by candidate for election**

According to Section 21 every candidate for election, who had received any foreign contribution, at any time within one hundred and eighty days immediately preceding the date on which he is duly nominated as such candidate,

shall give, within such time and in such manner as may be prescribed, an intimation to the Central Government or prescribed authority or both as to the amount of foreign contribution received by him, the source from which, and the manner in which, such foreign contribution was received and the purposes for which and the manner in which such foreign contribution was utilised by him.

### Disposal of Assets Created Out Of Foreign Contribution

Section 22 provides that where any person who was permitted to accept foreign contribution under this Act, ceases to exist or has become defunct, all the assets of such person shall be disposed of in accordance with the provisions contained in any law for the time being in force under which the person was registered or incorporated, and in the absence of any such law, the Central Government may, having regard to the nature of assets created out of foreign contribution received under this Act, by notification, specify that all such assets shall be disposed off by such authority, as it may specify, in such manner and procedure as may be prescribed.

### INSPECTION, SEARCH AND SEIZURE

#### Inspection of Accounts or Records

Section 23 states that if the Central Government has, for any reason, to be recorded in writing, any ground to suspect that any provision of this Act has been or is being, contravened by—

- (i) any political party; or
- (ii) any person; or
- (iii) any organisation; or
- (iv) any association,

it may, by general or special order, authorise such gazetted officer, holding a Group A post under the Central Government or such other officer or authority or organisation, as it may think fit (hereinafter referred to as the inspecting officer), to inspect any account or record maintained by such political party, person, organisation or association, as the case may be, and thereupon every such inspecting officer shall have the right to enter in or upon any premises at any reasonable hour, before sunset and after sunrise, for the purpose of inspecting the said account or record.

#### Seizure of Accounts or Records

As per Section 24, if, after inspection of an account or record referred to in section 23, the inspecting officer has any reasonable cause to believe that any provision of this Act or of any other law relating to foreign exchange has been, or is being, contravened, he may seize such account or record and produce the same before the court, authority or tribunal in which any proceeding is brought for such contravention:

Provided that the authorised officer shall return such account or record to the person from whom it was seized if no proceeding is brought within six months from the date of such seizure for the contravention disclosed by such account or record.

#### Seizure of Article or Currency or Security Received in Contravention of the Act

As per Section 25, if, any gazetted officer, authorised in this behalf by the Central Government by general or special order, has any reason to believe that any person has in his possession or control any article exceeding the value specified in sub-clause (i) of clause (h) of sub-section (1) of section 2 or currency or security whether Indian or foreign, in relation to which any provision of this Act has been or is being, contravened, he may seize such article or currency or security.

#### Disposal of Seized Article or Currency or Security

Section 26(1) provides that the Central Government, may, having regard to the value of article or currency or security, their vulnerability to theft or any relevant consideration, by notification, specify such article or currency or security which shall, as soon as may be after their seizure, be disposed of by such officer and in such manner, as the Central Government may, from time to time, determine after following the procedure hereinafter specified.

Section 26(2) states that the article or currency or security seized shall be forwarded without unnecessary delay to such officer as may be specified.

Where any article or currency or security has been seized and forwarded to such officer, the officer referred to in sub-section (1), shall prepare an inventory of such article or currency or security containing such details relating to their description, value or such other identifying particulars as the officer referred to in that sub-section may consider relevant to the identity of the article or the currency or security and make an application to any Magistrate for the purposes of certifying the correctness of the inventory so prepared.

Where an application is made under sub-section (2), the Magistrate shall, as soon as may be, allow the application.

Notwithstanding anything contained in the Indian Evidence Act, 1872 or the Code of Criminal Procedure, 1973, every court trying an offence under this Act, shall treat the inventory, as certified by the Magistrate, as primary evidence in respect of such offence.

Every officer acting above shall forthwith report the seizure to the Court of Session or Assistant Sessions Judge having jurisdiction for adjudging the confiscation under section 29.

### **Seizure to be Made In Accordance with Act 2 of 1974**

According to Section 27 of the Act, the provisions of the Code of Criminal Procedure, 1973 shall apply in so far as they are not inconsistent with the provisions of this Act to all seizures made under this Act.

### **ADJUDICATION**

#### **Confiscation of article or currency or security obtained in contravention of the Act.-**

Section 28 provides that any article or currency or security which is seized under section 25 shall be liable to confiscation if such article or currency or security has been adjudged under section 29 to have been received or obtained in contravention of this Act.

### **Adjudication of Confiscation**

According to Section 29(1) of the Act, any confiscation referred to in section 28 may be adjudged—

- (a) without limit, by the Court of Session within the local limits of whose jurisdiction the seizure was made; and
- (b) subject to such limits as may be prescribed, by such officer, not below the rank of an Assistant Sessions Judge, as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Section 29(2) provides that when an adjudication under sub-section (1) above is concluded by the Court of Session or Assistant Sessions Judge, as the case may be, the Sessions Judge or Assistant Sessions Judge may make such order as he thinks fit for the disposal by confiscation or delivery of seized article or currency or security, as the case may be, to any person claiming to be entitled to possession thereof or otherwise, or which has been used for the commission of any offence under this Act.

### **Procedure for Confiscation**

Section 30 provides that order of adjudication of confiscation shall not be made unless a reasonable opportunity of making a representation against such confiscation has been given to the person from whom any article or currency or security has been seized.

### **APPEAL AND REVISION**

#### **Appeal**

According to Section 31(1) of the Act, any person aggrieved by any order made under section 29 may prefer an appeal,—

- (i) where the order has been made by the Court of Session, to the High Court to which such Court is subordinate; or

- (ii) where the order has been made by any officer specified under clause (b) of sub-section (1) of section 29, to the Court of Session within the local limits of whose jurisdiction such order of adjudication of confiscation was made, within one month from the date of communication to such person of the order.

Provided that the appellate court may, if it is satisfied that the appellant was prevented by sufficient cause from preferring the appeal within the said period of one month, allow such appeal to be preferred within a further period of one month, but not thereafter.

Section 31(2) provides that any organisation referred to in clause (f) of sub-section (1) of section 3, or any person or association referred to in section 6 or section 9, aggrieved by an order made in pursuance of section 5 or by an order of the Central Government refusing to give permission under this Act, or by any order made by the Central Government under sub-section (2) or sub-section (4) of section 12, or sub-section (1) of section 14, as the case may be, may, within sixty days from the date of such order, prefer an appeal against such order to the High Court within the local limits of whose jurisdiction the appellant ordinarily resides or carries on business or personally works for gain, or; where the appellant is an organisation or association, the principal office of such organisation or association is located.

Every appeal preferred under this section shall be deemed to be an appeal from an original decree and the provisions of Order XLI of the First Schedule to the Code of Civil Procedure, 1908, shall, as far as may be, apply thereto as they apply to an appeal from an original decree.

### Revision of orders by Central Government

Section 32(1) provides that the Central Government may, either of its own motion or on an application for revision by the person registered under this Act, call for and examine the record of any proceeding under this Act in which any such order has been passed by it and may make such inquiry or cause such inquiry to be made and, subject to the provisions of this Act, may pass such order thereon as it thinks fit.

The Central Government shall not of its own motion revise any order under this section if the order has been made more than one year previously.

In the case of an application for revision under this section by the person referred to in sub-section (1), the application must be made within one year from the date on which the order in question was communicated to him or the date on which he otherwise came to know of it, whichever is earlier.

Provided that the Central Government may, if it is satisfied that such person was prevented by sufficient cause from making the application within that period, admit an application made after the expiry of that period.

The Central Government shall not revise any order where an appeal against the order lies but has not been made and the time within which such appeal may be made has not expired or such person has not waived his right of appeal or an appeal has been filed under this Act.

Every application by such person for revision under this section shall be accompanied by such fee, as may be prescribed.

*Explanation.*—An order by the Central Government declining to interfere shall, for the purposes of this section, be deemed not to be an order prejudicial to such person.

### OFFENCES AND PENALTIES

#### Making of False Statement, Declaration or Delivering False Accounts

As per Section 33 of the Act, any person, subject to this Act, who knowingly,—

- (i) gives false intimation under clause (c) of section 9 or section 18; or
- (ii) seeks prior permission or registration by means of fraud, false representation or concealment of material fact, shall, on conviction by a court, be liable to imprisonment for a term which may extend to six months or with fine or with both.

## **Penalty for Article or Currency or Security Obtained in Contravention of section 10**

Section 34 provides that any person, on whom any prohibitory order has been served under section 10, pays, delivers, transfers or otherwise deals with, in any manner whatsoever, any article or currency or security, whether Indian or foreign, in contravention of such prohibitory order, he shall be punished with imprisonment for a term which may extend to three years, or with fine, or with both; and notwithstanding anything contained in the Code of Criminal Procedure, 1973 (2 of 1974), the court trying such contravention may also impose on the person convicted an additional fine equivalent to the market value of the article or the amount of the currency or security in respect of which the prohibitory order has been contravened by him or such part thereof as the court may deem fit.

## **Punishment for contravention of any provision of the Act**

Section 35 states that whoever accepts, or assists any person, political party or organisation in accepting, any foreign contribution or any currency or security from a foreign source, in contravention of any provision of this Act or any rule or order made thereunder, shall be punished with imprisonment for a term which may extend to five years, or with fine, or with both.

## **Power to Impose Additional Fine Where Article or Currency or Security is Not Available for Confiscation**

As per Section 36 of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973, the court trying a person, who, in relation to any article or currency or security, whether Indian or foreign, does or omits to do any act which act or omission would render such article or currency or security liable to confiscation under this Act, may, in the event of the conviction of such person for the act or omission aforesaid, impose on such person a fine not exceeding five times the value of the article or currency or security or one thousand rupees, whichever is more, if such article or currency or security is not available for confiscation, and the fine so imposed shall be in addition to any other fine which may be imposed on such person under this Act.

## **Penalty for Offences Where No Separate Punishment Has Been Provided**

As per Section 37 of the Act, whoever fails to comply with any provision of this Act for which no separate penalty has been provided in this Act shall be punished with imprisonment for a term which may extend to one year, or with fine or with both.

## **Prohibition of Acceptance of Foreign Contribution**

Section 38 provides that notwithstanding anything contained in this Act, whoever, having been convicted of any offence under section 35 or section 37, in so far as such offence relates to the acceptance or utilisation of foreign contribution, is again convicted of such offence shall not accept any foreign contribution for a period of five years from the date of the subsequent conviction.

## **Offences by Companies**

Section 39 provides that where an offence under this Act or any rule or order made thereunder has been committed by a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render such person liable to any punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Notwithstanding anything contained above, where an offence under this Act or any rule or order made thereunder has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation.—For the purposes of this section,—

- (i) “company” means any body corporate and includes a firm, society, trade union or other association of individuals; and
- (ii) “director”, in relation to a firm, society, trade union or other association of individuals, means a partner in the firm or a member of the governing body of such society, trade union or other association of individuals.

### Bar on Prosecution of Offences under the Act

Section 40 states that no court shall take cognizance of any offence under this Act, except with the previous sanction of the Central Government or any officer authorised by that Government in this behalf.

### Composition of Certain Offences

According to Section 41(1) of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973, any offence punishable under this Act (whether committed by an individual or association or any officer or employee thereof), not being an offence punishable with imprisonment only, may, before the institution of any prosecution, be compounded by such officers or authorities and for such sums as the Central Government may, by notification in the Official Gazette, specify in this behalf.

Section 41(2) provides that nothing in sub-section (1) shall apply to an offence committed by an individual or association or its officer or other employee within a period of three years from the date on which a similar offence committed by it or him was compounded under this section.

Explanation.—For the purposes of this section, any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence.

As per Section 41(3), every officer or authority referred to in sub-section (1) shall exercise the powers to compound an offence, subject to the direction, control and supervision of the Central Government.

Every application for the compounding of an offence shall be made to the officer or authority referred to in sub-section (1) in such form and manner along with such fee as may be prescribed.

Where any offence is compounded before the institution of any prosecution, no prosecution shall be instituted in relation to such offence, against the offender in relation to whom the offence is so compounded.

Every officer or authority referred to in sub-section (1), while dealing with a proposal for the compounding of an offence for a default in compliance with any provision of this Act which requires by an individual or association or its officer or other employee to obtain permission or file or register with, or deliver or send to, the Central Government or any prescribed authority any return, account or other document, may, direct, by order, if he or it thinks fit to do so, any individual or association or its officer or other employee to file or register with, such return, account or other document within such time as may be specified in the order.

### LESSON ROUND-UP

- FCRA, 2010 regulate the acceptance and utilisation of foreign contribution or foreign hospitality by certain individuals or associations or companies and to prohibit acceptance and utilisation of foreign contribution or foreign hospitality for any activities detrimental to the national interest and for matters connected therewith or incidental thereto.
- In order to streamline the provisions of the Foreign Contribution (Regulation) Act, 2010 by strengthening the compliance mechanism, enhancing transparency and accountability in the receipt and utilisation of foreign contribution worth thousands of crores of rupees every year and facilitating genuine non-Governmental organisations or associations who are working for the welfare of the society, Parliament enacted the Foreign Contribution (Regulation) Amendment Act, 2020,

- The Act provides that persons having definite cultural, economic, educational, religious and social programmes should get themselves registered with the Government of India before accepting any 'foreign contribution'. In case a person falling in the above category is not registered with the Central Government, it can accept foreign contribution only after obtaining prior permission of the Central Government.
- Central Government is empowered to prohibit any person or organisation not specified in the Act from accepting any foreign contribution and to require any person or class of persons, not specified in it to obtain prior permission of the Central Government before accepting any foreign hospitality.
- Associations which were granted certificates of registration, such registration shall be valid for a period of five years.
- Any offence punishable under this act (whether committed by an individual or association or any officer or employee thereof), not being an offence punishable with imprisonment only, may, before the institution of any prosecution, be compounded by such officers or authorities and for such sums as the central government may, by notification in the official gazette, specify in this behalf.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. How does the FCRA, 2010 seeks to regulate the receipt of foreign contribution and foreign hospitality?
2. Define 'foreign contribution' and 'foreign source'.
3. Discuss the provisions of FCRA relevant to exemptions from acceptance of foreign contribution.
4. Explain the concept of 'organisation of a political nature' under the Foreign Contribution (Regulation) Act, 2010.
5. Discuss the powers of Central Government under FCRA to prohibit receipt of foreign contribution.

### LIST OF FURTHER READINGS

- Foreign Contribution (Regulation) Act, 2010 (Bare Act)

### OTHER REFERENCES (INCLUDING WEBSITES / VIDEO LINKS)

- <https://fcraonline.nic.in/home/index.aspx>

## Lesson 5

# Foreign Direct Investment – Regulation & Policy

### ***Key Concepts One Should Know***

- FDI in an Indian Company
- Competent Authority
- Instruments for Investments
- Caps on Investments

### ***Learning Objectives***

#### **To understand:**

- Eligible Investors under FDI
- Entry Routes for Investment i.e. Automatic Route, Government Route
- Competent Authority
- Instruments for Investments
- Prohibited and Permitted Sectors
- Conditions of FDI in Major Sector
- E-commerce Activity, Insurance etc.
- Conversion of ECB/lump sum fee/royalty etc. into Equity

### ***Regulatory Framework***

- Foreign Exchange Management Act, 1999
- Foreign Exchange Management (Non-Debt Instruments) Rules, 2019
- Foreign Exchange Management (Debt Instruments) Regulations, 2019

### ***Lesson Outline***

- Foreign Direct Investment
- Foreign Direct Investment Route
- Permitted Sectors/Activities
- Prohibited Sectors /Activities
- Foreign Direct Investment in major sectors
- Reporting Requirements
- Penalty
- LESSON ROUND-UP
- TEST YOURSELF

## CONSOLIDATED FDI POLICY 2020

### INTENT AND OBJECTIVE

Foreign Direct Investment (FDI) is considered as a major source of non-debt financial resource for the economic development. FDI flows into India have grown consistently since liberalization and are an important component of foreign capital since FDI infuses long term sustainable capital in the economy and contributes towards technology transfer, development of strategic sectors, greater innovation, and competition and employment creation amongst other benefits.

It is the intent and objective of the Government of India to attract and promote FDI in order to supplement domestic capital, technology and skills for accelerated economic growth and development. FDI, as distinguished from Foreign Portfolio Investment, has the connotation of establishing a 'lasting interest' in an enterprise that is resident in an economy other than that of the investor.

The Government has put in place a policy framework on FDI, which is transparent, predictable and easily comprehensible. This framework is embodied in the Circular on Consolidated FDI Policy, which may be updated on an annual basis, to capture and keep pace with the regulatory changes, effected in the interregnum. The Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce & Industry, Government of India makes policy pronouncements on FDI through Consolidated FDI Policy Circular/Press Notes/Press Releases which are notified by the Department of Economic Affairs (DEA), Ministry of Finance, Government of India as amendments to the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 under the Foreign Exchange Management Act, 1999 (FEMA). These notifications take effect from the date of issue of Press Notes/ Press Releases, unless specified otherwise therein. In case of any conflict, the relevant Notification under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 will prevail. The payment of inward remittance and reporting requirements are stipulated under the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 issued by the Reserve Bank of India (RBI). The regulatory framework, over a period of time, thus, consists of FEMA and Rules/Regulations thereunder, Consolidated FDI Policy Circular, Press Notes, Press Releases, Clarifications, etc.

The present consolidation subsumes and supersedes all Press Notes/Press Releases/Clarifications/Circulars issued by the DPIIT, which were in force as on October 15, 2020 and reflects the FDI Policy as on October 15, 2020. This Circular accordingly will take effect from October 15, 2020 and will remain in force until superseded in totality or in part thereof. Reference to any statute or legislation made in this Circular shall include modifications, amendments or re-enactments thereof.

Notwithstanding the rescission of earlier Press Notes/Press Releases/Clarifications/Circulars, anything done or any action taken or purported to have been done or taken under the rescinded Press Notes/Press Releases/Clarifications/Circulars prior to October 15, 2020, shall, in so far as it is not inconsistent with those Press Notes/Press Releases/Clarifications/Circulars, and applicable provisions under the FEMA and Rules/Regulations thereunder, be deemed to have been done or taken under the corresponding provisions of this circular and shall be valid and effective.

### DEFINITIONS

**'AD Category-I Bank'** means a bank (Scheduled Commercial, State or Urban Cooperative) which is authorized under Section 10(1) of FEMA to undertake all current and capital account transactions according to the directions issued by the RBI from time to time.

**'Authorized Bank'** shall have the meaning assigned to it under the Foreign Exchange Management (Deposit) Regulations, 2016.

**'Authorized Dealer'** means a person authorized as an authorized dealer under sub section (1) of section 10 of FEMA.

**'Automatic Route'** means the entry route through which investment by a person resident outside India does not require the prior approval of the Reserve Bank of India or the Central Government.

**'Capital'** means equity shares; fully, compulsorily & mandatorily convertible preference shares; fully, compulsorily & mandatorily convertible debentures and warrants.

**Note:** The equity shares issued in accordance with the provisions of the Companies Act, as applicable, shall include equity shares that have been partly paid. Preference shares and convertible debentures shall be required to be fully paid, and should be mandatorily and fully convertible. Further, 'warrant' includes Share Warrant issued by an Indian Company in accordance with the regulations by the Securities and Exchange Board of India (SEBI) and the provisions of the Companies Act, 2013.

**'Capital Account Transaction'** means a transaction which alters the assets or liabilities, including contingent liabilities, outside India of persons resident in India or assets or liabilities in India of persons resident outside India, and includes transactions as per Section 6 of FEMA.

**'Competent Authority'** means the concerned Administrative Ministry/Department empowered to grant government approval for foreign investment under the extant FDI Policy and FEMA Rules/Regulations.

**'Control'** shall include the right to appoint a majority of the directors or to control the management or policy decisions, exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders agreements or voting agreements. For the purposes of Limited Liability Partnership, 'control' will mean right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of the LLP.

**'Convertible Note'** means an instrument issued by a startup company acknowledging receipt of money initially as debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of such startup company, within a period not exceeding five years from the date of issue of the convertible note, upon occurrence of specified events as per the other terms and conditions agreed to and indicated in the instrument.

**'Depository Receipt'** (DR) means a foreign currency denominated instrument, whether listed on an international exchange or not, issued by a foreign depository in a permissible jurisdiction on the back of eligible securities issued or transferred to that foreign depository and deposited with a domestic custodian and includes 'global depository receipt' as defined in the Companies Act, 2013.

**'Domestic Custodian'** means a custodian of securities registered with the SEBI in accordance with the SEBI (Custodian of Securities) Regulations, 1996.

**'Domestic Depository'** means a custodian of securities registered with the SEBI and authorised by the issuing entity to issue Indian depository receipts.

**'ESOP'** means 'Employees' stock option' as defined under the Companies Act, 2013 and issued in accordance with the Companies Act, 2013 and SEBI regulations, as applicable.

**'Erstwhile Overseas Corporate Body'**(OCB) means a company, partnership firm, society and other corporate body owned directly or indirectly to the extent of at least sixty percent by non-resident Indians and includes overseas trust in which not less than sixty percent beneficial interest is held by non-resident Indians directly or indirectly but irrevocably and which was in existence on the date of commencement of the Foreign Exchange Management (Withdrawal of General Permission to Overseas Corporate Bodies (OCBs) Regulations, 2003 and immediately prior to such commencement was eligible to undertake transactions pursuant to the general permission granted under the regulations under FEMA.

**'Foreign Currency Convertible Bond'**(FCCB) means a bond issued under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993, as amended from time to time.

**'FDI'** or **'Foreign Direct Investment'** means investment through capital instruments by a person resident outside India in an unlisted Indian company; or in ten per cent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company;

Note:- In case an existing investment by a person resident outside India in capital instruments of a listed Indian company falls to a level below ten percent, of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI;

Explanation: - Fully diluted basis means the total number of shares that would be outstanding if all possible sources of conversion are exercised

**'Foreign Investment'** means any investment made by a person resident outside India on a repatriable basis in capital instruments of an Indian company or to the capital of a LLP;

Explanation: - If a declaration is made by a person as per the provisions of the Companies Act, 2013 about a beneficial interest being held by a person resident outside India, then even though the investment may be made by a resident Indian citizen, the same shall be counted as foreign investment;

Note:- A person resident outside India may hold foreign investment either as FDI or as FPI in any particular Indian company;

**'FDI linked performance conditions'** means the sector specific conditions for companies receiving foreign investment.

**'FEMA'** means the Foreign Exchange Management Act, 1999.

**'Foreign Portfolio Investment'** means any investment made by a person resident outside India through capital instruments where such investment is less than ten percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than ten percent of the paid-up value of each series of capital instrument of a listed Indian company.

**'Foreign Portfolio Investor'** (FPI) means a person registered in accordance with the provisions of Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019, as amended from time to time.

**'FVCI'** means a Foreign Venture Capital Investor incorporated and established outside India and registered with the SEBI under the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000, as amended from time to time.

**'Government Approval'** means the approval from the erstwhile Secretariat for Industrial Assistance (SIA), Department for Promotion of Industry and Internal Trade, Government of India and/ or the erstwhile Foreign Investment Promotion Board (FIPB) and/ or Competent Authority (Administrative Ministry/Department) of the Policy, as the case may be.

**'Government Route'** means the entry route through which investment by a person resident outside India requires prior Government approval and foreign investment received under this route shall be in accordance with the conditions stipulated by the Government in its approval

**'Group Company'** means two or more enterprises which, directly or indirectly, are in a position to:

- (i) exercise twenty-six percent or more of voting rights in other enterprise; or
- (ii) appoint more than fifty percent of members of Board of Directors in the other enterprise.

**'Holding Company'** shall have the same meaning as assigned to it under the Companies Act, as amended from time to time.

**'Indian Company'** means a company incorporated in India under the Companies Act, as applicable.

**'Investment'** means to subscribe, acquire, hold or transfer any security or unit issued by a person resident in India.

Explanation:-

- (i) Investment shall include to acquire, hold or transfer depository receipts issued outside India, the underlying of which is a security issued by a person resident in India;
- (ii) for the purpose of LLP, investment shall mean capital contribution or acquisition or transfer of profit shares;

**'Investment Vehicle'** shall mean an entity registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose and shall include (i)Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, (ii)Infrastructure Investment Trusts (InvITs) governed by the SEBI (InvITs) Regulations, 2014, and (iii)Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012

**'Investing Company'** means an Indian Company holding only investments in other Indian company(ies), directly or indirectly, other than for trading of such holdings/securities.

**'Investment on repatriable basis'** means investment, the sale or maturity proceeds of which, net of taxes, are eligible to be repatriated out of India and the expression 'investment on non-repatriable basis' shall be construed accordingly.

**'Joint Venture'** (JV) means an Indian entity incorporated in accordance with the laws and regulations in India in whose capital a non-resident entity makes an investment.

**'Limited Liability Partnership or LLP'** means a Limited Liability Partnership firm, formed and registered under the Limited Liability Partnership Act, 2008.

**'Listed Indian company'** means an Indian company which has any of its equity instruments or debt instruments listed on a recognised stock exchange in India and the expression "unlisted Indian company" shall be construed accordingly.

**'Manufacture'**, with its grammatical variations, means a change in a non-living physical object or article or thing- (a) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or (b) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

**'Non-resident entity'** means a 'person resident outside India' as defined under FEMA.

**'Non-Resident Indian'** (NRI) means an individual resident outside India who is a citizen of India.

**'OCI' or 'Overseas Citizen of India'** means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under section 7A of the Citizenship Act, 1955 (57 of 1955).

A company is considered as **'Owned'** by resident Indian citizens if more than 50% of the capital in it is beneficially owned by resident Indian citizens and / or Indian companies, which are ultimately owned and controlled by resident Indian citizens. A Limited Liability Partnership will be considered as owned by resident Indian citizens if more than 50% of the investment in such an LLP is contributed by resident Indian citizens and/or entities which are ultimately 'owned and controlled by resident Indian citizens' and such resident Indian citizens and entities have majority of the profit share.

- (i) 'Person' includes-
- (ii) an individual,
- (iii) a Hindu undivided family,
- (iv) a company,
- (v) a firm,
- (vi) an association of persons or a body of individuals whether incorporated or not,
- (vii) every artificial juridical person, not falling within any of the preceding sub-clauses,
- (viii) any agency, office, or branch owned or controlled by such person.

**'Person resident in India'** means-

- (i) a person residing in India for more than one hundred and eighty-two days during the course of the preceding financial year but does not include-
  - (A) A person who has gone out of India or who stays outside India, in either case-
    - (a) for or on taking up employment outside India, or
    - (b) for carrying on outside India a business or vocation outside India, or
    - (c) for any other purpose, in such circumstances as would indicate his intention to stay outside India for an uncertain period;
  - (B) A person who has come to or stays in India, in either case, otherwise than-
    - (a) for or on taking up employment in India; or
    - (b) for carrying on in India a business or vocation in India, or

- (c) for any other purpose, in such circumstances as would indicate his intention to stay in India for an uncertain period;
- (ii) any person or body corporate registered or incorporated in India,
- (iii) an office, branch or agency in India owned or controlled by a person resident outside India,
- (iv) an office, branch or agency outside India owned or controlled by a person resident in India.

**'Person resident outside India'** means a person who is not a Person resident in India.

**'RBI'** means the Reserve Bank of India established under the Reserve Bank of India Act, 1934.

**'Resident Entity'** means 'Person resident in India' excluding an individual.

**'Resident Indian Citizen'** shall be interpreted in line with the definition of 'person resident in India' as per FEMA, 1999, read in conjunction with the Indian Citizenship Act, 1955.

**'SEBI'** means the Securities and Exchange Board of India established under the Securities and Exchange Board of India Act, 1992.

**'SEZ'** means a Special Economic Zone as defined in Special Economic Zone Act, 2005.

**'Startup Company'** means a private company incorporated under the Companies Act, 2013 and identified under G.S.R. 127(E) dated 19th February, 2019 issued by the DPIIT, Ministry of Commerce and Industry.

**'Sweat Equity Shares'** means sweat equity shares defined under the Companies Act, 2013.

**'Total Foreign Investment'** means the total of foreign investment and indirect foreign investment and the same will be reckoned on a fully diluted basis.

**'Transferable Development Rights'** (TDR) shall have the meaning assigned to it in the regulations made under subsection (2) of section 6 of FEMA.

**'Unit'** shall mean beneficial interest of an investor in an Investment Vehicle

**'Venture Capital Fund'** (VCF) means a fund established in the form of a trust, a company including a body corporate and registered under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012.

## GENERAL CONDITIONS ON FDI

### ELIGIBLE INVESTORS

1. (a) A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route. Further, a citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.
  - (b) In the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction/purview of the para 1(a), such subsequent change in beneficial ownership will also require Government approval.
2. NRIs resident in Nepal and Bhutan as well as citizens of Nepal and Bhutan are permitted to invest in the capital of Indian companies on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid only by way of inward remittance in free foreign exchange through normal banking channels.
3. OCBs have been derecognized as a class of investors in India with effect from September 16, 2003. Erstwhile OCBs which are incorporated outside India and are not under the adverse notice of RBI can make fresh investments as incorporated non-resident entities in accordance with the FDI Policy and Foreign Exchange Management (Non-Debt Instrument) Rules, 2019.

4. A company, trust and partnership firm incorporated outside India and owned and controlled by NRIs can invest in India with the special dispensation as available to NRIs under the FDI Policy.
5. Foreign Portfolio Investors (FPI) may make investments in the manner and subject to the terms and conditions specified in Schedule II of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
6. Registered FPIs and NRIs can invest/trade through a registered broker in the capital of Indian Companies on recognised Indian Stock Exchanges as per the applicable Schedule under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, as amended from time to time.
7. A Foreign Venture Capital Investor (FVCI) may make investments in the manner and subject to the terms and conditions specified in Schedule VII of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
8. An NRI or an OCI may subscribe to National Pension System governed and administered by Pension Fund Regulatory and Development Authority (PFRDA), provided such subscriptions are made through normal banking channels and the person is eligible to invest as per the provisions of the PFRDA Act. The annuity/ accumulated saving will be repatriable.

## ELIGIBLE INVESTEE ENTITIES

### 1. Indian Company

Indian companies can issue capital against FDI.

### 2. Partnership Firm/Proprietary Concern

- (i) A Non-Resident Indian (NRI) can invest in the capital of a firm or a proprietary concern in India on non-repatriation basis provided;
  - (a) Amount is invested by inward remittance or out of NRE/FCNR(B)/NRO account maintained with Authorized Dealers/Authorized banks.
  - (b) The firm or proprietary concern is not engaged in any agricultural/plantation or real estate business or print media sector.
  - (c) Amount invested shall not be eligible for repatriation outside India.
    - Investments with repatriation option: NRIs may seek prior permission of Reserve Bank for investment in sole proprietorship concerns/partnership firms with repatriation option. The application will be decided in consultation with the Government of India.
    - Investment by non-residents other than NRIs: A person resident outside India other than NRIs may make an application and seek prior approval of Reserve Bank for making investment in the capital of a firm or a proprietorship concern or any association of persons in India. The application will be decided in consultation with the Government of India.
    - Restrictions: An NRI is not allowed to invest in a firm or proprietorship concern engaged in any agricultural/plantation activity or real estate business or print media.

### 3. Trusts

Investment by a person resident outside India is not permitted in Trusts other than in 'VCF' registered and regulated by SEBI and 'Investment vehicle'.

### 4. Limited Liability Partnerships (LLPs)

Foreign Investment in LLPs is permitted subject to the following conditions:

Foreign Investment is permitted under the automatic route in Limited Liability Partnership (LLPs) operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions.

An Indian company or an LLP, having foreign investment, is also permitted to make downstream investment in another company or LLP in sectors in which 100% FDI is allowed under the automatic route and there are no FDI-linked performance conditions.

Conversion of an LLP having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into a company is permitted under automatic route. Similarly, conversion of a company having foreign investment and operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions, into an LLP is permitted under automatic route.

Foreign Investment in LLP is subject to the compliance of the conditions of LLP Act, 2008.

## 5. Investment Vehicle

An entity being 'investment vehicle' registered and regulated under relevant regulations framed by SEBI or any other authority designated for the purpose including Real Estate Investment Trusts (REITs) governed by the SEBI (REITs) Regulations, 2014, Infrastructure Investment Trusts (InvITs) governed by the SEBI (InvITs) Regulations, 2014, Alternative Investment Funds (AIFs) governed by the SEBI (AIFs) Regulations, 2012 is permitted to receive foreign investment from a person resident outside India (other than an individual who is citizen of or any other entity which is registered / incorporated in Pakistan or Bangladesh) in the manner and subject to the terms and conditions specified under Schedule VIII of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

## 6. Startup Companies

Start-ups can issue equity or equity linked instruments or debt instruments to FVCI against receipt of foreign remittance, as per the Schedule VII of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. In addition, start-ups can issue convertible notes to person resident outside India subject to the following conditions:

- (i) A person resident outside India (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered/incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian startup company for an amount of twenty-five lakh rupees or more in a single tranche.
- (ii) Explanation: For the purpose of this Regulation, a 'startup company' means a private company incorporated under the Companies Act, 2013 or Companies Act, 1956 and recognised as such in accordance with notification number G.S.R. 127(E) dated 19th February, 2019 issued by the DPIIT, Ministry of Commerce and Industry, and as amended from time to time.
- (iii) A startup company engaged in a sector where foreign investment requires Government approval may issue convertible notes to a non-resident only with approval of the Government.
- (iv) Explanation: For the purpose of this regulation, the issue of shares against such convertible notes shall have to be in accordance with the Schedule I of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
- (v) A startup company issuing convertible notes to a person resident outside India shall receive the amount of consideration by inward remittance through banking channels or by debit to the NRE / FCNR (B) / Escrow account maintained by the person concerned in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016, as amended from time to time.
- (vi) Provided that an escrow account for the above purpose shall be closed immediately after the requirements are completed or within a period of six months, whichever is earlier. However, in no case continuance of such escrow account shall be permitted beyond a period of six months.
- (vii) NRIs may acquire convertible notes on non-repatriation basis in accordance with Schedule IV of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.
- (viii) A person resident outside India may acquire or transfer, by way of sale, convertible notes, from or to, a person resident in or outside India, provided the transfer takes place in accordance applicable pricing guidelines under FEMA. Prior approval from the Government shall be obtained for such acquisitions or transfers in case the startup company is engaged in a sector which requires Government approval.
- (ix) The startup company issuing convertible notes shall be required to furnish reports as prescribed by the RBI.

## 7. Other Entities

FDI in resident entities other than those mentioned above is not permitted.

### ENTRY ROUTES FOR INVESTMENT

Investments can be made by non-residents in the equity shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares of an Indian company, through the Automatic Route or the Government Route. Under the Automatic Route, the non-resident investor or the Indian company does not require any approval from Government of India for the investment. Under the Government Route, prior approval of the Government of India is required. Proposals for foreign investment under Government Route, are considered by respective Administrative Ministry/Department.

Foreign investment in sectors/activities under government approval route will be subject to government approval where:

- (i) An Indian company is being established with foreign investment and is not owned by a resident entity or
- (ii) An Indian company is being established with foreign investment and is not controlled by a resident entity or
- (iii) The control of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/ passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demergers, acquisition etc. or
- (iv) The ownership of an existing Indian company, currently owned or controlled by resident Indian citizens and Indian companies, which are owned or controlled by resident Indian citizens, will be/is being transferred/ passed on to a non-resident entity as a consequence of transfer of shares and/or fresh issue of shares to non-resident entities through amalgamation, merger/demergers, acquisition etc.
- (v) It is clarified that foreign investment shall include all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedule I (FDI), II (FPI), III (NRI), VI (LLPs), VII (FVCI), VIII (Investment Vehicles) and IX (DRs) of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. FCCBs and DRs having underlying instruments which can be issued under Schedule IX, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment.
- (vi) Investment by NRIs under Schedule IV of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 will be deemed to be domestic investment at par with the investment made by residents.
- (vii) A company, trust and partnership firm incorporated outside India and owned and controlled by non-resident Indians will be eligible for investments under Schedule IV of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and such investment will also be deemed domestic investment at par with the investment made by residents.

### CAPS ON INVESTMENTS

Investments can be made by person resident outside India in the capital of a resident entity only to the extent of the percentage of the total capital as specified in the FDI policy.

### ENTRY CONDITIONS ON INVESTMENT

Investments by non-residents can be permitted in the capital of a resident entity in certain sectors/activity with entry conditions. Such conditions may include norms for minimum capitalization, lock-in period, etc.

### CONDITIONS ON INVESTMENT BESIDES ENTRY CONDITIONS

1. Besides the entry conditions on foreign investment, the investment/investors are required to comply with all relevant sectoral laws, regulations, rules, security conditions, and state/local laws/regulations.

2. Establishment of branch office, liaison office or project office or any other place of business in India shall be governed by the Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. Further, acquisition or transfer of immovable property in India by citizens of certain countries shall be regulated as per the relevant provisions under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, as amended from time to time.

## FOREIGN INVESTMENT INTO/DOWNSTREAM INVESTMENT BY ELIGIBLE INDIAN ENTITIES

The Guidelines for calculation of total foreign investment, both direct and indirect in an Indian company/LLP, at every stage of investment, including downstream investment, are as under:

### Total Foreign Investment i.e. Direct and Indirect Foreign Investment in eligible Indian entities

Investment in an eligible Indian entity can be made both by non-resident as well as resident Indian entities. Any non-resident investment in an Indian company is direct foreign investment. Investment by resident Indian entities could again comprise of both resident and non-resident investment. Thus, such an Indian company would have indirect foreign investment if the Indian investing company has foreign investment in it. The indirect investment can also be a cascading investment i.e. through multi-layered structure.

For the purpose of computation of indirect foreign investment in an Indian company, foreign investment in an Indian company shall include all types of foreign investments i.e. FDI; investment by , FPIs (holding as on March 31); NRIs; ADRs; GDRs; Foreign Currency Convertible Debentures (FCCBs); Investment Vehicles fully, compulsorily and mandatorily convertible preference shares and fully, compulsorily and mandatorily convertible Debentures or units of an Investment Vehicle, regardless of whether the said investments have been made under Schedule I, II, , III, VI, IX and X of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

#### ***Guidelines for calculation of total foreign investment i.e. direct and indirect foreign investment***

##### (i) Counting of direct foreign investment

All investment directly by a non-resident entity into the Indian company/ LLP would be counted towards foreign investment.

##### (ii) Counting of indirect foreign investment

(a) The foreign investment through the investing Indian company/LLP would not be considered for calculation of the indirect foreign investment in case of Indian companies/LLPs which are 'owned **and** controlled' by resident Indian citizens and/or Indian Companies/LLPs which are owned and controlled by resident Indian citizens.

(aa) Indian 'owned and controlled' as defined in Regulation 14 of the principal Regulations as defined in RBI Notification No.362/2015-RB dated February 15, 2016.

Provided that for sponsors or managers or investment managers organized in a form other than companies or LLPs, SEBI shall determine whether the sponsor or manager or investment manager is foreign owned and controlled.

(b) For cases where condition (a) above is not satisfied or if the investing company is owned **or** controlled by 'non-resident entities', the entire investment by the investing company/LLP into the subject Indian Company would be considered as indirect foreign investment, provided that, as an exception, the indirect foreign investment in only the 100% owned subsidiaries of operating-cum-investing/investing companies, will be limited to the foreign investment in the operating-cum-investing/ investing company. This exception is made since the downstream investment of a 100% owned subsidiary of the holding company is akin to investment made by the holding company and the downstream investment should be a mirror image of the holding company. This exception, however, is strictly for those cases where the entire capital of the downstream subsidiary is owned by the holding company.

### Illustration

To illustrate, if the indirect foreign investment is being calculated for Company X which has investment through an investing Company Y having foreign investment, the following would be the method of calculation:

- (A) Where Company Y has foreign investment less than 50%- Company X would not be taken as having any indirect foreign investment through Company Y.
- (B) Where Company Y has foreign investment of say 75% and:
  - (i) invests 26% in Company X, the entire 26% investment by Company Y would be treated as indirect foreign investment in Company X;
  - (ii) invests 80% in Company X, the indirect foreign investment in Company X would be taken as 80%;
  - (iii) Where Company X is a wholly owned subsidiary of Company Y (i.e. Company Y owns 100% shares of Company X), then only 75% would be treated as indirect foreign equity and the balance 25% would be treated as resident held equity. The indirect foreign equity in Company X would be computed in the ratio of 75:25 in the total investment of Company Y in Company X.
  - (iv) The total foreign investment would be the sum total of direct and indirect foreign investment.

The above methodology of calculation would apply at every stage of investment in Indian companies and thus to each and every Indian company.
- (v) Additional conditions
  - (a) The full details about the foreign investment including ownership details etc. in Indian company(s) and information about the control of the company(s) would be furnished by the Company(s) to the Government of India at the time of seeking approval.
  - (b) In any sector/activity, where Government approval is required for foreign investment and in cases where there are any *inter-se* agreements between/amongst shareholders which have an effect on the appointment of the Board of Directors or on the exercise of voting rights or of creating voting rights disproportionate to shareholding or any incidental matter thereof, such agreements will have to be informed to the approving authority. The approving authority will consider such *inter-se* agreements for determining ownership and control when considering the case for approval of foreign investment.
  - (c) In all sectors attracting sectoral caps, the balance equity i.e. beyond the sectoral foreign investment cap, would specifically be beneficially owned by/held with/in the hands of resident Indian citizens and Indian companies, owned and controlled by resident Indian citizens.
  - (d) In the I& B sector where the sectoral cap is up to 49%, the company would need to be 'owned and controlled' by resident Indian citizens and Indian companies, which are owned and controlled by resident Indian citizens.
- (C) For this purpose, the equity held by the largest Indian shareholder would have to be at least 51% of the total equity, excluding the equity held by Public Sector Banks and Public Financial Institutions, as defined in Section 4A of the Companies Act, 1956 or Section 2 (72) of the Companies Act, 2013, as the case may be. The term 'largest Indian shareholder', used in this clause, will include any or a combination of the following:
  - (I) In the case of an individual shareholder,
    - (a) The individual shareholder,
    - (b) A relative of the shareholder within the meaning of Section 2 (77) of Companies Act, 2013.
    - (c) A company/group of companies in which the individual shareholder/HUF to which he belongs has management and controlling interest.

- (II) In the case of an Indian Company,
  - (aa) The Indian Company
  - (bb) A group of Indian companies under the same management and ownership control.
- (D) For the purpose of this Clause, "Indian company" shall be a company which must have a resident Indian or a relative as defined under Section 2 (77) of Companies Act, 2013/ HUF, either singly or in combination holding at least 51% of the shares.
- (E) Provided that, in case of a combination of all or any of the above, each of the parties shall have entered into a legally binding agreement to act as a single unit in managing the matters of the applicant company.
  - (a) If a declaration is made by persons as per section 187C of the Companies Act, 1956 or section 89 of the Companies Act, 2013, as the case may be about a beneficial interest being held by a non-resident entity, then even though the investment may be made by a resident Indian citizen, the same shall be counted as foreign investment.

The above mentioned policy and methodology would be applicable for determining the total foreign investment in all sectors, except in sectors where it is specified in a statute or rule there under. The above methodology of determining direct and indirect foreign investment therefore does not apply to the Insurance Sector which will continue to be governed by the relevant Regulation. Similarly, above methodology will also not apply to downstream investments by an Investment Vehicle. Relevant conditions of downstream investment by Investment Vehicles are as under:

- (i) Downstream investment by an Investment Vehicle shall be regarded as foreign investment if either the Sponsor or the Manager or the Investment Manager is not Indian 'owned and controlled' as defined in Regulation 14 of the principal Regulations as defined in RBI Notification No. 362/2015-RB dated February 15, 2016. Provided that for sponsors or managers or investment managers organized in a form other than companies or LLPs, SEBI shall determine whether the sponsor or manager or investment manager is foreign owned and controlled.

Explanation 1: Ownership and control is clearly determined as per the extant FDI policy. AIF is a pooled investment vehicle. 'Control' of the AIF should be in the hands of 'sponsors' and 'managers/investment managers', with the general exclusion of others. In case the 'sponsors' and 'managers/investment managers' of the AIF are individuals, for the treatment of downstream investment by such AIF as domestic, 'sponsors' and 'managers/investment managers' should be resident Indian citizens.

Explanation 2: The extent of foreign investment in the corpus of the Investment Vehicle will not be a factor to determine as to whether downstream investment of the Investment Vehicle concerned is foreign investment or not.

- (ii) Downstream investment by an Investment Vehicle that is reckoned as foreign investment shall have to conform to the sectoral caps and conditions / restrictions, if any, as applicable to the company in which the downstream investment is made as per the FDI Policy.
- (iii) Downstream investment in an LLP by an Investment Vehicle that is reckoned as foreign investment has to conform to the provisions of Schedule VIII of the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 as well as the extant FDI policy for foreign investment in LLPs.
- (iv) An Alternative Investment Fund Category III with foreign investment shall make portfolio investment in only those securities or instruments in which a Registered Foreign Portfolio Investor is allowed to invest under the principal Regulations.
- (v) The Investment Vehicle receiving foreign investment shall be required to make such report and in such format to Reserve Bank of India or to SEBI as may be prescribed by them from time to time.

Any foreign investment already made in accordance with the guidelines in existence prior to February 13, 2009 (date of issue of Press Note 2 of 2009) would not require any modification to conform to these guidelines. All other investments, past and future, would come under the ambit of these new guidelines.

***Foreign investment into an Indian company engaged only in the activity of investing in the capital of other Indian company (ies) (regardless of its ownership or control):***

1. Foreign Investment in Investing Companies registered as Non-Banking Financial Companies (NBFC) with the RBI, being overall regulated, would be under 100% automatic route.
2. Foreign Investment in Core Investment Companies (CICs) and other investing companies, engaged in the activity of investing in the capital of other Indian company(ies)/LLPs, is permitted under Government approval route. CICs will have to additionally follow RBI's regulatory framework for CICs.
3. For undertaking activities which are under automatic route and without foreign investment linked performance conditions, Indian company which does not have any operations and also does not have any downstream investments, will be permitted to have infusion of foreign investment under automatic route. However, approval of the Government will be required for such companies for infusion of foreign investment for undertaking activities which are under Government route, regardless of the amount or extent of foreign investment. Further, as and when such a company commences business(s) or makes downstream investment, it will have to comply with the relevant sectoral conditions on entry route, conditionalities and caps.

*Note:* Foreign investment into other Indian companies/LLPs would be in accordance/ compliance with the relevant sectoral conditions on entry route, conditionalities and caps.

***Downstream investment by an eligible Indian entity which is not owned and/or controlled by resident entity(ies)***

1. Downstream investment by an eligible Indian entity, which is not owned and/or controlled by resident entity(ies), into another Indian company, would be in accordance/compliance with the relevant sectoral conditions on entry route, conditionalities and caps, with regard to the sectors in which the latter Indian company is operating.

*Note:* Downstream investment/s made by a banking company, as defined in clause(c) of Section 5 of the Banking Regulation Act, 1949, incorporated in India, which is owned and/or controlled by non-residents/a non-resident entity/non-resident entities, under Corporate Debt Restructuring (CDR), or other loan restructuring mechanism, or in trading books, or for acquisition of shares due to defaults in loans, shall not count towards indirect foreign investment. However, their 'strategic downstream investment' shall count towards indirect foreign investment. For this purpose, 'strategic downstream investments' would mean investment by these banking companies in their subsidiaries, joint ventures and associates.

2. Downstream investments by eligible Indian entities/LLPs will be subject to the following conditions:
  - (i) Such an entity is required to notify its downstream investment to RBI in Form DI as well as on Foreign Investment Facilitation Portal in the form available at [www.fifp.gov.in](http://www.fifp.gov.in) within 30 days of such investment, even if capital instruments have not been allotted along with the modality of investment in new/existing ventures (with/without expansion programme);
  - (ii) Downstream investment by way of induction of foreign investment in an existing Indian Company to be duly supported by a resolution of the Board of Directors as also a share-holders agreement, if any;
  - (iii) Issue/transfer/pricing/valuation of capital shall be in accordance with applicable FEMA/SEBI guidelines;
  - (iv) For the purpose of downstream investment, the eligible Indian entities making the downstream investments would have to bring in requisite funds from abroad and not leverage funds from the domestic market. This would, however, not preclude downstream companies/LLPs, with operations, from raising debt in the domestic market. Downstream investments through internal accruals are permissible, subject to the applicable provisions. For the purposes of foreign investment policy, internal accruals will mean as profits transferred to reserve account after payment of taxes.

## COMPETENT AUTHORITY

**Following are the Competent Authorities for grant of approval for foreign investment for sectors/activities requiring Government approval:**

| S. No. | Activity/ sector  | Administrative Ministry/Department                                      |
|--------|---|---|
| 1      | Mining  | Ministry of Mines   |
| 2      | Defence   |   |
|        | a) Items requiring Industrial Licence under the Industries (Development & Regulation) Act, 1951, and/or Arms Act, 1959 for which the powers have been delegated by Ministry of Home Affairs to DPIIT  | Department of Defence Production, Ministry of Defence                   |
|        | (b) Manufacturing of Small Arms and Ammunitions covered under Arms Act 1959   | Ministry of Home Affairs  |
| 3      | Broadcasting  | Ministry of Information & Broadcasting                                  |
| 4      | Print Media/Digital Media   |   |
| 5      | Civil Aviation  | Ministry of Civil Aviation  |
| 6      | Satellites  | Department of Space   |
| 7      | Telecommunication   | Department of Telecommunications  |
| 8      | Private Security Agencies   | Ministry of Home Affairs  |
| 9      | (a) Applications involving investments from an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country {as required in terms of Press Note 3 of 2020 read with Foreign Exchange Management (Non-debt Instruments) Amendment Rules, 2020 dated 22.04.2020} | Concerned Administrative Ministry/Department as identified by the DPIIT |
|        | (b) Cases pertaining to sectors/activities under Government approval route requiring security clearance as per the extant Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, FDI Policy and security guidelines, as amended from time to time  | Nodal Administrative Ministries/Departments                             |
| 10     | Trading (Multi Brand Retail Trading and Food Product retail trading)  | Department for Promotion of Industry and Internal Trade                 |
| 11     | FDI proposals by Non-Resident Indians (NRIs)/ Export Oriented Units requiring approval of the Government  | Concerned Administrative Ministry/Department as identified by the DPIIT |
| 12     | Applications relating to issue of equity shares under the FDI policy under the Government route for import of capital goods/machinery/equipment (excluding second-hand machinery)   |   |
| 13     | Applications relating to issue of equity shares for pre-operative/pre-incorporation expenses (including payments of rent etc.)  |   |
| 14     | Financial services activity which are not regulated by any Financial Sector Regulator or where only part of the financial services activity is regulated or where there is doubt regarding the regulatory oversight   | Department of Economic Affairs  |
| 15     | Applications for foreign investment into a Core Investment Company or an Indian company engaged only in the activity of investing in the capital of other India Company(ies)  |   |

|    |                              |                                  |
|----|------------------------------|----------------------------------|
| 16 | Banking (Public and Private) | Department of Financial Services |
| 17 | Pharmaceuticals              | Department of Pharmaceuticals    |

In respect of sectors/activities which are presently under automatic route but required Government approval earlier as per the extant policy during the relevant period, concerned administrative Ministry/Department would be the Competent Authorities for the grant of post-facto approval for foreign investment.

In respect of applications in which there is a doubt about the Administrative Ministry/Department concerned, DPIIT shall identify the Administrative Ministry/Department where the application will be processed.

Proposals for foreign investment would be examined by Competent Authorities as per the Standard Operating Procedure laid down by DPIIT (available at <http://www.fifp.gov.in/Forms/SOP.pdf>).

In case of proposals involving total foreign equity inflow of more than Rs. 5000 crore, Competent Authority shall place the same for consideration of Cabinet Committee on Economic Affairs (CCEA).

The CCEA would also consider the proposals which may be referred to it by the Minister-in-charge of the concerned Competent Authority.

In respect of proposals where the Competent Authority proposes to reject the proposals or in cases where conditions for approval are stipulated in addition to the conditions laid down in the FDI policy or sectoral laws/regulations, concurrence of DPIIT shall compulsorily be sought by the Competent Authority. 2

The monitoring of the compliance of conditions under the FDI approvals, including the past cases approved by the Government, shall be done by the concerned Administrative Ministries/Departments.

### CASES WHICH DO NOT REQUIRE FRESH APPROVAL

- (i) Companies may not require fresh approval of the Government for bringing in additional foreign investment into the same entity, in the following cases:
- (ii) Entities, the activities of which had earlier required the prior approval of the Government and which had, accordingly, earlier obtained the prior approval of the Government for their initial foreign investment but subsequently such activities/sectors have been placed under automatic route;
- (iii) Entities, the activities of which had sectoral caps earlier and which had, accordingly, earlier obtained the prior approval of the Government for their initial foreign investment but subsequently such caps were removed/increased and the activities placed under the automatic route; provided that such additional investment along with the initial/original investment does not exceed the sectoral caps;
- (iv) Additional foreign investment into the same entity where the prior approval of the Government had been obtained earlier for the initial/original foreign investment due to requirements of Press Note 18 of 1998 or Press Note 1 of 2005 and the prior approval of the Government under the FDI policy is not required for any other reason/purpose; and
- (v) Additional foreign investment up to cumulative amount of Rs 5000 crore into the same entity within an approved foreign equity percentage/or into a wholly owned subsidiary.

### ONLINE FILING OF APPLICATIONS FOR GOVERNMENT APPROVAL

Guidelines for e-filing of applications, filing of amendment applications and instructions to applicants are available at the Foreign Investment Facilitation Portal ([www.fifp.gov.in](http://www.fifp.gov.in)).

### PROHIBITED SECTORS

FDI is prohibited in:

- a) Lottery Business including Government/private lottery, online lotteries, etc.
- b) Gambling and Betting including casinos etc.

- c) Chit funds
- d) Nidhi company
- e) Trading in Transferable Development Rights (TDRs)
- f) Real Estate Business or Construction of Farm Houses
- g) 'Real estate business' shall not include development of townships, construction of residential /commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations 2014.
- h) Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes Activities/ sectors not open to private sector investment e.g.(I) Atomic Energy and (II) Railway operations (other than permitted activities).

*Foreign technology collaboration in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for Lottery Business, Gambling and Betting activities.*

### PERMITTED SECTORS

- (a) In the sectors /activities stated below, FDI up to the limit indicated against each sector/activity is allowed, subject to applicable laws/regulations; security and other conditionalities. In sectors/activities not listed below, FDI is permitted up to 100% on the automatic route, subject to applicable laws/regulations; security and other conditionalities. Wherever there is a requirement of minimum capitalization, it shall include share premium received along with the face value of the share, only when it is received by the company upon issue of the shares to the non-resident investor. Amount paid by the transferee during post-issue transfer of shares beyond the issue price of the share, cannot be taken into account while calculating minimum capitalization requirement.
- (b) Sectoral cap i.e. the maximum amount which can be invested by foreign investors in an entity, unless provided otherwise, is composite and includes all types of foreign investments, direct and indirect, regardless of whether the said investments have been made under Schedules I (FDI), II (FPI), III (NRI), VI (LLPs), VII (FVCI), VIII (Investment Vehicles), and IX (DRs), respectively, of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019. FCCBs and DRs having underlying of instruments which can be issued under Schedule IX, being in the nature of debt, shall not be treated as foreign investment. However, any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned as foreign investment under the composite cap.
- (c) Foreign investment in sectors under Government approval route resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities will be subject to Government approval. Foreign investment in sectors under automatic route but with conditionalities, resulting in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities, will be subject to compliance of such conditionalities.
- (d) The sectors which are already under 100% automatic route and are without conditionalities would not be affected.
- (e) Notwithstanding anything contained in paragraphs (a) and (c) above, portfolio investment, up to aggregate foreign investment level as permitted under Schedule II of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 will not be subject to either Government approval or compliance of sectoral conditions, as the case may be, if such investment does not result in transfer of ownership and/or control of Indian entities from resident Indian citizens to non-resident entities. Other foreign investments will be subject to conditions of Government approval and compliance of sectoral conditions as laid down in the FDI policy.
- (f) Total foreign investment, direct and indirect, in an entity will not exceed the sectoral/statutory cap.
- (g) Any existing foreign investment already made in accordance with the policy in existence would not require any modification to conform to amendments introduced through Press Note 8 (2015 Series).

- (h) Wherever the foreign investor wishes to specify a particular auditor/audit firm having international network for the Indian investee company, then audit of such investee companies should be carried out as joint audit wherein one of the auditors should not be part of the same network.
- (i) The onus of compliance of above provisions will be on the investee company.

## AGRICULTURE & ANIMAL HUSBANDRY

| Sector/Activity  | % of Equity/<br>FDI Cap | Entry Route      |
|--|-------------------------|------------------|
| <p>a) Floriculture, Horticulture, and Cultivation of Vegetables &amp; Mushrooms under controlled conditions;</p> <p>b) Development and Production of seeds and planting material;</p> <p>c) Animal Husbandry (including breeding of dogs), Pisciculture, Aquaculture, Apiculture; and</p> <p>d) Services related to agro and allied sectors</p> <p>Note: Besides the above, FDI is not allowed in any other agricultural sector/activity</p> | <b>100%</b>             | <b>Automatic</b> |

'Cultivation under controlled conditions' for the categories of floriculture, horticulture, cultivation of vegetables and mushrooms is the practice of cultivation wherein rainfall, temperature, solar radiation, air humidity and culture medium are controlled artificially. Control in these parameters may be effected through protected cultivation under green houses, net houses, poly houses or any other improved infrastructure facilities where micro-climatic conditions are regulated anthropogenically.

## PLANTATION SECTOR

| Sector/Activity   | % of Equity/FDI Cap | Entry Route      |
|---|---------------------|------------------|
| <p>(i) Tea sector including tea plantations</p> <p>(ii) Coffee plantations</p> <p>(iii) Rubber plantations</p> <p>(iv) Cardamom plantations</p> <p>(v) Palm oil tree plantations</p> <p>(vi) Olive oil tree plantations</p> <p>Note: Besides the above, FDI is not allowed in any other plantation sector/activity.</p> | <b>100</b>          | <b>Automatic</b> |

Prior approval of the State Government concerned is required in case of any future land use change.

## MINING

| Sector/Activity   | % of Equity/<br>FDI Cap | Entry Route      |
|---|-------------------------|------------------|
| <b>Mining and Exploration of metal and non-metal ores</b> including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores; subject to the Mines and Minerals (Development & Regulation) Act, 1957. | <b>100%</b>             | <b>Automatic</b> |

|  |             |                  |
|--|-------------|------------------|
| <b>Coal &amp; Lignite</b>  | <b>100%</b> | <b>Automatic</b> |
| <p>(1) Coal &amp; Lignite mining for captive consumption by power projects, iron &amp; steel and cement units and other eligible activities permitted under and subject to the provisions of Coal Mines (Special Provisions) Act, 2015 and the Mines and Minerals (Development and Regulation) Act, 1957.</p> <p>(2) Setting up coal processing plants like washeries subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing.</p> <p>(3) For sale of coal, coal mining activities including associated processing infrastructure subject to the provisions of Coal Mines (Special Provisions) Act, 2015 and the Mines and Minerals (Development and Regulation) Act, 1957 as amended from time to time and other relevant Acts on the subject.</p> |             |                  |
| <p>Mining and Mineral Separation of titanium bearing minerals and ores, its value addition and integrated activities</p> <p>Mining and mineral separation of titanium bearing minerals &amp; ores, its value addition and integrated activities subject to sectoral regulations and the Mines and Minerals (Development and Regulation Act 1957).</p>  | <b>100%</b> | <b>Automatic</b> |

### Other conditions:

- (i) FDI for separation of titanium bearing minerals & ores will be subject to the following additional conditions viz.:
  - (A) value addition facilities are set up within India along with transfer of technology;
  - (B) disposal of tailings during the mineral separation shall be carried out in accordance with Rules framed by the Atomic Energy Regulatory Board such as Atomic Energy (Radiation Protection) Rules, 2004 and the Atomic Energy (Safe Disposal of Radioactive Wastes) Rules, 1987.
- (ii) FDI will not be allowed in mining of "prescribed substances" listed in the Notification No. S.O. 61(E), dated 18.1.2006, issued by the Department of Atomic Energy.

"Associated Processing Infrastructure" includes coal washery, crushing, coal handling, and separation (magnetic and non-magnetic)

#### Clarification:

For titanium bearing ores such as Ilmenite, Leucoxene and Rutile, manufacture of titanium dioxide pigment and titanium sponge constitutes value addition. Ilmenite can be processed to 'produce 'Synthetic Rutile or Titanium Slag as an intermediate value-added product.

The objective is to ensure that the raw material available in the country is utilized for setting up downstream industries and the technology available internationally is also made available for setting up such industries within the country. Thus, if with the technology transfer, the objective of the FDI Policy can be achieved, the conditions prescribed at (i) (A) above shall be deemed to be fulfilled.

## PETROLEUM & NATURAL GAS

| Sector/Activity   | % of Equity/FDI Cap | Entry Route |
|---|---------------------|-------------|
| Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector, subject to the existing sectoral policy and regulatory framework in the oil marketing sector and the policy of the Government on private participation in exploration of oil and the discovered fields of national oil companies. | 100%                | Automatic   |
| Petroleum refining by the Public Sector Undertakings (PSU), without any disinvestment or dilution of domestic equity in the existing PSUs.  | 49%                 | Automatic   |

## MANUFACTURING

Subject to the provisions of the FDI policy, foreign investment in 'manufacturing' sector is under automatic route. Manufacturing activities may be either self-manufacturing by the investee entity or contract manufacturing in India through a legally tenable contract, whether on Principal to Principal or Principal to Agent basis. Further, a manufacturer is permitted to sell its products manufactured in India through wholesale and/or retail, including through e-commerce, without Government approval.

Notwithstanding the FDI policy provisions on trading sector, 100% FDI under Government approval route is allowed for retail trading, including through e-commerce, in respect of food products manufactured and/or produced in India.

## DEFENCE

| Sector/Activity  | % of Equity/ FDI Cap | Entry Route  |
|--|----------------------|--|
| Defence Industry subject to Industrial license under the Industries (Development & Regulation) Act, 1951 and Manufacturing of small arms and ammunition under the Arms Act, 1959 | 100%                 | Automatic up to 74% Government route beyond 74% wherever it is likely to result in access to modern technology or for other reasons to be recorded |

### Other Conditions

- (i) FDI up to 74% under automatic route shall be permitted for companies seeking new industrial licenses.
- (ii) Infusion of fresh foreign investment up to 49%, in a company not seeking industrial license or which already has Government approval for FDI in Defence, shall require mandatory submission of a declaration with the Ministry of Defence in case change in equity /shareholding pattern or transfer of stake by existing investor to new foreign investor for FDI up to 49%, within 30 days of such change. Proposal for raising FDI beyond 49% from such companies will require Government approval.
- (iii) Licence applications will be considered by the Department for Promotion of Industry and Internal Trade, Ministry of Commerce & Industry, in consultation with Ministry of Defence and Ministry of External Affairs.
- (iv) Foreign investment in the sector is subject to security clearance by the Ministry of Home Affairs and as per guidelines of the Ministry of Defence.

- (v) Investee company should be structured to be self-sufficient in the areas of product design and development. The investee/joint venture company along with the manufacturing facility, should also have maintenance and life cycle support facility of the product being manufactured in India.
- (vi) Foreign Investments in the Defence Sector shall be subject to scrutiny on grounds of National Security and Government reserves the right to review any foreign investment in the Defence Sector that affects or may affect national security.

### BROADCASTING CARRIAGE SERVICES

| Sector/Activity   | % of Equity/ FDI Cap | Entry Route     |
|---|----------------------|-----------------|
| <b>(1) Teleports</b> (setting up of up-linking HUBs/Teleports);<br><b>(2) Direct to Home (DTH);</b><br><b>(3) Cable Networks</b> (Multi System operators (MSOs) operating at National or State or District level and undertaking upgradation of networks towards digitalization and addressability);<br><b>(4) Mobile TV;</b><br><b>(5) Headend-in-the Sky Broadcasting Service(HITS)</b> | 100%                 | Automatic Route |
| <b>Cable Networks</b> (Other MSOs not undertaking upgradation of networks towards digitalization and addressability and Local Cable Operators (LCOs))   | 100%                 | Automatic Route |
| <i>Note:</i><br><br>Infusion of fresh foreign investment, beyond 49% in a company not seeking license/permission from sectoral Ministry, resulting in change in the ownership pattern or transfer of stake by existing investor to new foreign investor, will require Government approval.  |                      |                 |

### BROADCASTING CONTENT SERVICES

| Sector/Activity  | % of Equity/ FDI Cap | Entry Route |
|--|----------------------|-------------|
| Terrestrial Broadcasting FM (FM Radio), subject to such terms and conditions, as specified from time to time, by Ministry of Information & Broadcasting, for grant of permission for setting up of FM Radio stations | 49                   | Government  |
| Up-linking of 'News & Current Affairs' TV Channels   | 49                   | Government  |
| Uploading/Streaming of News & Current Affairs through Digital Media  | 26                   | Government  |
| Up-linking of Non- 'News & Current Affairs' TV Channels/ Down-linking of TV Channels   | 100                  | Automatic   |

### Conditions for Broadcasting Sector

1. FDI for Up-linking/Down-linking TV Channels will be subject to compliance with the relevant Up-linking/ Down-linking Policy notified by the Ministry of Information & Broadcasting from time to time.
2. Foreign investment (FI) in companies engaged in all the aforestated services will be subject to relevant regulations and such terms and conditions, as may be specified from time to time, by the Ministry of Information and Broadcasting.

3. The foreign investment (FI) limit in companies engaged in the aforestated activities shall include, in addition to FDI, Foreign Portfolio Investors (FPIs), Qualified Foreign Investors (QFIs), Non-Resident Indians (NRIs), Foreign Currency Convertible Bonds (FCCBs), American Depository Receipts (ADRs), Global Depository Receipts (GDRs) and convertible preference shares held by foreign entities.
4. Foreign investment in the aforestated broadcasting carriage services will be subject to the following security conditions/terms:

### ***Mandatory Requirement for Key Executives of the Company***

- (i) The majority of Directors on the Board of the Company shall be Indian citizens.
- (ii) The Chief Executive Officer (CEO), Chief Officer in-charge of technical network operations and Chief Security Officer should be resident Indian citizens.

### ***Security Clearance of Personnel***

- (i) The Company, all Directors on the Board of Directors and such key executives like Managing Director/Chief Executive Officer, Chief Financial Officer (CFO), Chief Security Officer (CSO), Chief Technical Officer (CTO), Chief Operating Officer (COO), shareholders who individually hold 10% or more paid-up capital in the company and any other category, as may be specified by the Ministry of Information and Broadcasting from time to time, shall require to be security cleared.
- (ii) In case of the appointment of Directors on the Board of the Company and such key executives like Managing Director/Chief Executive Officer, Chief Financial Officer (CFO), Chief Security Officer (CSO), Chief Technical Officer (CTO), Chief Operating Officer (COO), etc., as may be specified by the Ministry of Information and Broadcasting from time to time, prior permission of the Ministry of Information and Broadcasting shall have to be obtained.
- (iii) It shall be obligatory on the part of the company to also take prior permission from the Ministry of Information and Broadcasting before effecting any change in the Board of Directors.
- (iv) The Company shall be required to obtain security clearance of all foreign personnel likely to be deployed for more than 60 days in a year by way of appointment, contract, and consultancy or in any other capacity for installation, maintenance, operation or any other services prior to their deployment. The security clearance shall be required to be obtained every two years.

### ***Permission vis-à-vis Security Clearance***

- (v) The permission shall be subject to permission holder/licensee remaining security cleared throughout the currency of permission. In case the security clearance is withdrawn, the permission granted is liable to be terminated forthwith.
- (vi) In the event of security clearance of any of the persons associated with the permission holder/licensee or foreign personnel being denied or withdrawn for any reasons whatsoever, the permission holder/licensee will ensure that the concerned person resigns or his services terminated forthwith after receiving such directives from the Government, failing which the permission/license granted shall be revoked and the company shall be disqualified to hold any such Permission/license in future for a period of five years.

### ***Infrastructure/Network/Software related requirement***

- (vii) The officers/officials of the licensee companies dealing with the lawful interception of services will be resident India citizens.
- (viii) Details of infrastructure/network diagram (technical details of the network) could be provided, on a need basis only, to equipment suppliers/manufacturers and the affiliate of the licensee company. Clearance from the licensor would be required if such information is to be provided to anybody else.
- (ix) The Company shall not transfer the subscribers' databases to any person/place outside India unless permitted by relevant law.
- (x) The Company must provide traceable identity of their subscribers.

### ***Monitoring, Inspection and Submission of Information***

- (xi) The Company should ensure that necessary provision (hardware/software) is available in their equipment for doing the lawful interception and monitoring from a centralized location as and when required by Government.
- (xii) The company, at its own costs, shall, on demand by the government or its authorized representative, provide the necessary equipment, services and facilities at designated place(s) for continuous monitoring or the broadcasting service by or under supervision of the Government or its authorized representative.
- (xiii) The Government of India, Ministry of Information & Broadcasting or its authorized representative shall have the right to inspect the broadcasting facilities. No prior permission/intimation shall be required to exercise the right of Government or its authorized representative to carry out the inspection. The company will, if required by the Government or its authorized representative, provide necessary facilities for continuous monitoring for any particular aspect of the company's activities and operations. Continuous monitoring, however, will be confined only to security related aspects, including screening of objectionable content.
- (xiv) The inspection will ordinarily be carried out by the Government of India, Ministry of Information & Broadcasting or its authorized representative after reasonable notice, except in circumstances where giving such a notice will defeat the very purpose of the inspection.
- (xv) The company shall submit such information with respect to its services as may be required by the Government or its authorized representative, in the format as may be required, from time to time.
- (xvi) The permission holder/licensee shall be liable to furnish the Government of India or its authorized representative or TRAI or its authorized representative, such reports, accounts, estimates, returns or such other relevant information and at such periodic intervals or such times as may be required.
- (xvii) The service providers should familiarize/train designated officials or the Government or officials of TRAI or its authorized representative(s) in respect of relevant operations/features of their systems.

### ***National Security Conditions***

- (xviii) It shall be open to the licensor to restrict the Licensee Company from operating in any sensitive area from the National Security angle. The Government of India, Ministry of Information and Broadcasting shall have the right to temporarily suspend the permission of the permission holder/Licensee in public interest or for national security for such period or periods as it may direct. The company shall immediately comply with any directives issued in this regard failing which the permission issued shall be revoked and the company disqualified to hold any such permission in future for a period of five years.
- (xix) The company shall not import or utilize any equipment, which are identified as unlawful and/or render network security vulnerable.

### ***Other Conditions***

- (xx) Licensor reserves the right to modify these conditions or incorporate new conditions considered necessary in the interest of national security and public interest or for proper provision of broadcasting services.
- (xxi) Licensee will ensure that broadcasting service installation carried out by it should not become a safety hazard and is not in contravention of any statute, rule or regulation and public policy.

'Magazine', for the purpose of these guidelines, will be defined as a periodical publication, brought out on non-daily basis, containing public news or comments on public news.

Foreign investment would also be subject to the Guidelines for Publication of Indian editions of foreign magazines dealing with news and current affairs issued by the Ministry of Information & Broadcasting on 4.12.2008, as amended from time to time.

## PRINT MEDIA

| Sector/Activity   | % of Equity/ FDI Cap | Entry Route |
|---|----------------------|-------------|
| Publishing of newspaper and periodicals dealing with news and current affairs   | 26                   | Government  |
| Publication of Indian editions of foreign magazines dealing with news and current affairs   | 26                   | Government  |
| Publishing/printing of scientific and technical magazines/specialty journals/ periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting. | 100                  | Government  |
| Publication of facsimile edition of foreign newspapers  | 100                  | Government  |

### Other Conditions:

- (i) 'Magazine', for the purpose of these guidelines, will be defined as a periodical publication, brought out on non-daily basis, containing public news or comments on public news.
- (ii) Foreign investment would also be subject to the Guidelines for Publication of Indian editions of foreign magazines dealing with news and current affairs issued by the Ministry of Information & Broadcasting on 4.12.2008, as amended from time to time.
- (i) FDI should be made by the owner of the original foreign newspapers whose facsimile edition is proposed to be brought out in India.
- (ii) Publication of facsimile edition of foreign newspapers can be undertaken only by an entity incorporated or registered in India under the provisions of the Companies Act, as applicable.
- (iii) Publication of facsimile edition of foreign newspaper would also be subject to the Guidelines for publication of newspapers and periodicals dealing with news and current affairs and publication of facsimile edition of foreign newspapers issued by Ministry of Information & Broadcasting on 31.3.2006, as amended from time to time.

## AIRPORTS

| Sector/Activity         | % of Equity/ FDI Cap | Entry Route |
|-------------------------|----------------------|-------------|
| (a) Greenfield projects | 100%                 | Automatic   |
| (b) Existing projects   | 100%                 | Automatic   |

## AIR TRANSPORT SERVICES

| Sector/Activity  | % of Equity/ FDI Cap | Entry Route   |
|--|----------------------|---|
| (1) (a) Scheduled Air Transport Service*/ Domestic Scheduled Passenger Airline | 100%                 | Automatic up to 49%<br>(Automatic up to 100% for NRIs)<br>Government route beyond 49% |
| (b) Regional Air Transport Service   |                      |   |
| (2) Non-Scheduled Air Transport Services                                       | 100%                 | Automatic   |
| (3) Helicopter services/seaplane services requiring DGCA approval              | 100%                 | Automatic   |

\*As per Schedule XI of Aircraft Rules, 1937, Air Operator Certificate to operate Scheduled air transport services (including Domestic Scheduled Passenger Airline or Regional Air Transport Service) may be granted to a company or a body corporate provided that: -

- (a) it is registered and has its principal place of business within India;
- (b) the Chairman and at least two-thirds of its Directors are citizens of India; and
- (c) its substantial ownership and effective control is vested in Indian nationals

## OTHER SERVICES UNDER CIVIL AVIATION SECTOR

| Sector/Activity  | % of Equity/ FDI Cap | Entry Route |
|--|----------------------|-------------|
| (1) Ground Handling Services subject to sectoral regulations and security clearance                        | 100%                 | Automatic   |
| (2) Maintenance and Repair organizations; flying training institutes; and technical training institutions. | 100%                 | Automatic   |

The Civil Aviation sector includes Airports, Scheduled and Non-Scheduled domestic passenger airlines, Helicopter services/Seaplane services, Ground Handling Services, Maintenance and Repair organizations; Flying training institutes; and Technical training institutions.

For the purposes of the Civil Aviation sector:

- (i) "Airport" means a landing and taking off area for aircrafts, usually with runways and aircraft maintenance and passenger facilities and includes aerodrome as defined in clause (2) of section 2 of the Aircraft Act, 1934;
- (ii) "Aerodrome" means any definite or limited ground or water area intended to be used, either wholly or in part, for the landing or departure of aircraft, and includes all buildings, sheds, vessels, piers and other structures thereon or pertaining thereto;
- (iii) "Air transport service" means a service for the transport by air of persons, mails or any other thing, animate or inanimate, for any kind of remuneration whatsoever, whether such service consists of a single flight or series of flights;
- (iv) "Air Transport Undertaking" means an undertaking whose business includes the carriage by air of passengers or cargo for hire or reward;
- (v) "Aircraft component" means any part, the soundness and correct functioning of which, when fitted to an aircraft, is essential to the continued airworthiness or safety of the aircraft and includes any item of equipment;
- (vi) "Helicopter" means a heavier-than-air aircraft supported in flight by the reactions of the air on one or more power driven rotors on substantially vertical axis;
- (vii) "Scheduled air transport service" means an air transport service undertaken between the same two or more places and operated according to a published time table or with flights so regular or frequent that they constitute a recognizably systematic series, each flight being open to use by members of the public;
- (viii) "Non-Scheduled air transport service" means any service which is not a scheduled air transport service;
- (ix) "Seaplane" means an aeroplane capable normally of taking off from and alighting solely on water;
- (x) "Ground Handling" means (i) ramp handling, (ii) traffic handling both of which shall include the activities as specified by the Ministry of Civil Aviation through the Aeronautical Information Circulars from time to time, and (iii) any other activity specified by the Central Government to be a part of either ramp handling or traffic handling.

### Other Conditions

- (a) Air Transport Services would include Domestic Scheduled Passenger Airlines; Non-Scheduled Air Transport Services, helicopter and seaplane services.
- (b) Foreign airlines are allowed to participate in the equity of companies operating Cargo airlines, helicopter and seaplane services, as per the limits and entry routes mentioned above.

- (c) Foreign airlines are also allowed to invest in the capital of Indian companies, operating scheduled and non-scheduled air transport services, up to the limit of 49% of their paid-up capital. Such investment would be subject to the following conditions:
- (i) It would be made under the Government approval route,
  - (ii) The 49% limit will subsume FDI and FPI investment,
  - (iii) The investments so made would need to comply with the relevant regulations of SEBI, such as the Issue of Capital and Disclosure Requirements (ICDR) Regulations/Substantial Acquisition of Shares and Takeovers (SAST) Regulations, as well as other applicable rules and regulations,
  - (iv) All foreign nationals likely to be associated with Indian scheduled and non-scheduled air transport services, as a result of such investment shall be cleared from security view point before deployment and
  - (v) All technical equipment that might be imported into India as a result of such investment shall require clearance from the relevant authority in the Ministry of Civil Aviation.
- (d) In addition to the above conditions, foreign investment in M/s Air India Ltd. shall be subject to the following conditions:
- (i) Foreign investment(s) in M/s Air India Ltd., including that of foreign airline(s) shall not exceed 49% either directly or indirectly except in case of those NRIs, who are Indian Nationals, where foreign investment(s) is permitted up to 100% under automatic route.
  - (ii) Substantial ownership and effective control of M/s Air India Ltd. shall continue to be vested in Indian Nationals as stipulated in Aircraft Rules, 1937.
- (e) FDI in Civil Aviation is subject to provisions of Aircraft Rules, 1937, as amended from time to time.

Note:

- (i) The FDI limits/entry routes mentioned for Airport and Air Transport Service, are applicable in the situation where there is no investment by foreign airline. Any investment by foreign airlines in companies operating in Air Transport Services, including in M/s Air India Limited, shall be subject to para (b) and (c) above.
- (ii) The dispensation for those NRIs, who are Indian Nationals regarding FDI up to 100% will also continue in respect of the investment regime specified at para (c) (ii) and (d) above.

## CONSTRUCTION DEVELOPMENT: TOWNSHIPS, HOUSING, BUILT-UP INFRASTRUCTURE

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Construction-development projects (which would include development of townships, construction of residential/commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships) | 100%            | Automatic   |

Each phase of the construction development project would be considered as a separate project for the purposes of FDI policy. Investment will be subject to the following conditions:

- A. (i) the investor will be permitted to exit on completion of the project or after development of trunk infrastructure i.e. roads, water supply, street lighting, drainage and sewerage.
  - (ii) Notwithstanding anything contained at (A) (i) above, a foreign investor will be permitted to exit and repatriate foreign investment before the completion of project under automatic route, provided that a lock-in-period of three years, calculated with reference to each tranche of foreign investment has been completed. Further, transfer of stake from one non-resident to another non-resident, without repatriation of investment will neither be subject to any lock-in period nor to any government approval.
- (B) The project shall conform to the norms and standards, including land use requirements and provision of community amenities and common facilities, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government/Municipal/Local Body concerned.

- (C) The Indian investee company will be permitted to sell only developed plots. For the purposes of this policy “developed plots” will mean plots where trunk infrastructure i.e. roads, water supply, street lighting, drainage and sewerage, have been made available.
- (D) The Indian investee company shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under applicable rules/bye-laws/regulations of the State Government/Municipal/Local Body concerned.
- (E) The State Government/Municipal/Local Body concerned, which approves the building/development plans, will monitor compliance of the above conditions by the developer.

*Note:*

- (i) It is clarified that FDI is not permitted in an entity which is engaged or proposes to engage in real estate business, construction of farm houses and trading in transferable development rights (TDRs).  
“Real estate business” means dealing in land and immovable property with a view to earning profit therefrom and does not include development of townships, construction of residential/ commercial premises, roads or bridges, educational institutions, recreational facilities, city and regional level infrastructure, townships. Further, earning of rent/ income on lease of the property, not amounting to transfer, will not amount to real estate business.
- (ii) Condition of lock-in period at (A) above will not apply to Hotels & Tourist Resorts, Hospitals, Special Economic Zones (SEZs), Educational Institutions, Old Age Homes and investment by NRIs.
- (iii) Completion of the project will be determined as per the local bye-laws/rules and other regulations of State Governments.
- (iv) It is clarified that 100% FDI under automatic route is permitted in completed projects for operation and management of townships, malls/ shopping complexes and business centres. Consequent to foreign investment, transfer of ownership and/or control of the investee company from residents to non-residents is also permitted. However, there would be a lock-in-period of three years, calculated with reference to each tranche of FDI, and transfer of immovable property or part thereof is not permitted during this period.
- (v) “Transfer”, in relation to FDI policy on the sector, includes—
  - (a) the sale, exchange or relinquishment of the asset; or
  - (b) the extinguishment of any rights therein; or
  - (c) the compulsory acquisition thereof under any law; or
  - (d) any transaction involving the allowing of the possession of any immovable property to be taken or retained in part performance of a contract of the nature referred to in section 53A of the Transfer of Property Act, 1882 (4 of 1882); or
  - (e) any transaction, by acquiring shares in a company or by way of any agreement or any arrangement or in any other manner whatsoever, which has the effect of transferring, or enabling the enjoyment of, any immovable property.
- (vi) it is clarified that real-estate broking service does not amount to real estate business and 100% foreign investment is allowed in the activity under automatic route.

## INDUSTRIAL PARKS

| Sector/Activities                  | % of Equity/FDI | Entry Route |
|------------------------------------|-----------------|-------------|
| Industrial Parks -new and existing | 100%            | Automatic   |

### Conditions for Industrial Parks

- (i) "Industrial Park" is a project in which quality infrastructure in the form of plots of developed land or built up space or a combination with common facilities, is developed and made available to all the allottee units for the purposes of industrial activity.
- (ii) "Infrastructure" refers to facilities required for functioning of units located in the Industrial Park and includes roads (including approach roads), railway line/sidings including electrified railway lines and connectivities to the main railway line, water supply and sewerage, common effluent treatment facility, telecom network, generation and distribution of power, air conditioning.
- (iii) "Common Facilities" refer to the facilities available for all the units located in the industrial park, and include facilities of power, roads (including approach roads), railway line/sidings including electrified railway lines and connectivities to the main railway line, water supply and sewerage, common effluent treatment, common testing, telecom services, air conditioning, common facility buildings, industrial canteens, convention/conference halls, parking, travel desks, security service, first aid center, ambulance and other safety services, training facilities and such other facilities meant for common use of the units located in the Industrial Park.

"Allocable area" in the Industrial Park means-

- (a) in the case of plots of developed land- the net site area available for allocation to the units, excluding the area for common facilities.
- (b) in the case of built up space- the floor area and built up space utilized for providing common facilities.
- (c) in the case of a combination of developed land and built-up space- the net site and floor area available for allocation to the units excluding the site area and built up space utilized for providing common facilities.
- (d) "Industrial Activity" means manufacturing; electricity; gas and water supply; post and telecommunications; software publishing, consultancy and supply; data processing, database activities and distribution of electronic content; other computer related activities; basic and applied R&D on bio-technology, pharmaceutical sciences/life sciences, natural sciences and engineering; business and management consultancy activities; and architectural, engineering and other technical activities.

FDI in Industrial Parks would not be subject to the conditionalities applicable for construction development projects, provided the Industrial Parks meet with the under-mentioned conditions:

- (i) it would comprise of a minimum of 10 units and no single unit shall occupy more than 50% of the allocable area;
- (ii) the minimum percentage of the area to be allocated for industrial activity shall not be less than 66% of the total allocable area.

### SATELLITES- ESTABLISHMENT AND OPERATION

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Satellites- establishment and operation, subject to the sectoral guidelines of Department of Space/ISRO | 100%            | Automatic   |

### PRIVATE SECURITY AGENCIES

| Sector/Activities       | % of Equity / FDI | Entry Route  |
|-------------------------|-------------------|--|
| Private Security Agency | 74%               | Automatic up to 49%<br>Government route beyond 49% and up to 74% |

### Other Conditions

FDI in Private Security Agencies is subject to compliance with Private Security Agencies (Regulation) (PSAR) Act, 2005, as amended from time to time.

For the purposes of FDI policy on the sector, terms "Private Security Agencies", "Private Security" and "Armoured Car Service" will have the same meaning as provided under PSAR Act, 2005, which is reproduced as under:

"Private Security Agency" means a person or body of persons other than a government agency, department or organisation engaged in the business of providing private security services including training to private security guards or their supervisor or providing private security guards to any industrial or business undertaking or a company or any other person or property;

"Private Security" means security provided by a person, other than a public servant, to protect or guard any person or property or both and includes provision of armoured car service;

"Armoured Car Service" means the service provided by deployment of armed guards along with armoured car and such other related services which may be notified by the Central Government or as the case may be, the State Government from time to time.

## TELECOM SERVICES

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Telecom Services<br><br>(including Telecom Infrastructure Providers Category-I)<br><br>All telecom services including Telecom Infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified License (Access Services), Unified License, National/International Long Distance, Commercial V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS), All types of ISP licenses, Voice Mail/Audiotex/UMS, Resale of IPLC, Mobile Number Portability Services, Infrastructure Provider Category-I (providing dark fibre, right of way, duct space, tower) except Other Service Providers. | 100%            | Automatic   |

FDI in Telecom sector is subject to observance of licensing and security conditions by licensee as well as investors as notified by the Department of Telecommunications (DoT) from time to time, except "Other Service Providers", which are allowed 100% FDI on the automatic route.

## TRADING

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Cash & Carry Wholesale Trading/Wholesale Trading (including sourcing from MSEs) | 100%            | Automatic   |

Cash & Carry Wholesale trading/Wholesale trading, would mean sale of goods/merchandise to retailers, industrial, commercial, institutional or other professional business users or to other wholesalers and related subordinated service providers. Wholesale trading would, accordingly, imply sales for the purpose of trade, business and profession, as opposed to sales for the purpose of personal consumption. The yardstick to determine whether the sale is wholesale or not would be the type of customers to whom the sale is made and not the size and volume of sales. Wholesale trading would include resale, processing and thereafter sale, bulk imports with ex-port/ex-bonded warehouse business sales and B2B e-Commerce.

### **Guidelines for cash & carry wholesale trading/wholesale trading (wt):**

- For undertaking WT, requisite licenses/registration/ permits, as specified under the relevant Acts/ Regulations/Rules/Orders of the State Government/Government Body/Government Authority/Local Self-Government Body under that State Government should be obtained.
- Except in case of sales to Government, sales made by the wholesaler would be considered as 'cash & carry wholesale trading/wholesale trading' with valid business customers, only when WT are made to the following entities:

- (i) Entities holding applicable tax registration; or
- (ii) Entities holding trade licenses i.e. a license/registration certificate/membership certificate/registration under Shops and Establishment Act, issued by a Government Authority/Government Body/Local Self-Government Authority, reflecting that the entity/person holding the license/ registration certificate/membership certificate, as the case may be, is itself/ himself/herself engaged in a business involving commercial activity; or
- (iii) Entities holding permits/license etc. for undertaking retail trade (like tehbazari and similar license for hawkers) from Government Authorities/Local Self Government Bodies; or
- (iv) Institutions having certificate of incorporation or registration as a society or registration as public trust for their self-consumption.

*Note:* An entity, to whom WT is made, may fulfill any one of the 4 conditions at (I) to (IV) above.

- (c) Full records indicating all the details of such sales like name of entity, kind of entity, registration/license/ permit etc. number, amount of sale etc. should be maintained on a day to day basis.
- (d) WT of goods would be permitted among companies of the same group. However, such WT to group companies taken together should not exceed 25% of the total turnover of the wholesale venture.
- (e) WT can be undertaken as per normal business practice, including extending credit facilities subject to applicable regulations.
- (f) A wholesale/cash & carry trader can undertake retail trading, subject to the conditions as applicable. An entity undertaking wholesale/cash and carry as well as retail business will be mandated to maintain separate books of accounts for these two arms of the business and duly audited by the statutory auditors. Conditions of the FDI policy for wholesale/cash and carry business and for retail business have to be separately complied with by the respective business arms.

## E-COMMERCE ACTIVITIES

| Sector/Activities             | % of Equity/FDI | Entry Route      |
|-------------------------------|-----------------|------------------|
| <b>E -Commerce Activities</b> | <b>100%</b>     | <b>Automatic</b> |

Subject to provisions of FDI Policy, e-commerce entities would engage only in Business to Business (B2B) e-commerce and not in Business to Consumer (B2C) e-commerce.

**E-commerce-** E-commerce means buying and selling of goods and services including digital products over digital & electronic network.

**E-commerce entity-** E-commerce entity means a company incorporated under the Companies Act 1956 or the Companies Act 2013 or a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in section 2 (v) (iii) of FEMA 1999, owned or controlled by a person resident outside India and conducting the e-commerce business.

**Inventory based model of e-commerce-** Inventory based model of e-commerce means an e-commerce activity where inventory of goods and services is owned by e-commerce entity and is sold to the consumers directly.

**Marketplace based model of e-commerce-** Marketplace based model of e-commerce means providing of an information technology platform by an e-commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.

### **Guidelines for Foreign Direct Investment on E-Commerce Sector**

- (i) 100% FDI under automatic route is permitted in marketplace model of e-commerce.
- (ii) FDI is not permitted in inventory-based model of e-commerce.
- (iii) Digital & electronic network will include network of computers, television channels and any other internet application used in automated manner such as web pages, extranets, mobiles etc.

- (iv) Marketplace e-commerce entity will be permitted to enter into transactions with sellers registered on its platform on B2B basis.
- (v) E-commerce marketplace may provide support services to sellers in respect of warehousing, logistics, order fulfillment, call centre, payment collection and other services.
- (vi) E-commerce entity providing a marketplace will not exercise ownership or control over the inventory i.e. goods purported to be sold. Such an ownership or control over the inventory will render the business into inventory-based model. Inventory of a vendor will be deemed to be controlled by e-commerce marketplace entity if more than 25% of purchases of such vendor are from the marketplace entity or its group companies.
- (vii) An entity having equity participation by e-commerce marketplace entity or its group companies, or having control on its inventory by e-commerce marketplace entity or its group companies, will not be permitted to sell its products on the platform run by such marketplace entity.
- (viii) In marketplace model goods/services made available for sale electronically on website should clearly provide name, address and other contact details of the seller. Post sales, delivery of goods to the customers and customer satisfaction will be responsibility of the seller.
- (ix) In marketplace model, payments for sale may be facilitated by the e-commerce entity in conformity with the guidelines of the Reserve Bank of India.
- (x) In marketplace model, any warrantee/ guarantee of goods and services sold will be responsibility of the seller.
- (xi) E-commerce entities providing marketplace will not directly or indirectly influence the sale price of goods or services and shall maintain level playing field. Services should be provided by e-commerce marketplace entity or other entities in which e-commerce marketplace entity has direct or indirect equity participation or common control, to vendors on the platform at arm's length and in a fair and non-discriminatory manner. Such services will include but not limited to fulfilment, logistics, warehousing, advertisement/ marketing, payments, financing etc. Cash back provided by group companies of marketplace entity to buyers shall be fair and non-discriminatory. For the purposes of this clause, provision of services to any vendor on such terms which are not made available to other vendors in similar circumstances will be deemed unfair and discriminatory.
- (xii) Guidelines on cash and carry wholesale trading will apply on B2B e-commerce.
- (xiii) E-commerce marketplace entity will not mandate any seller to sell any product exclusively on its platform only.
- (xiv) E-commerce marketplace entity with FDI shall have to obtain and maintain a report of statutory auditor by 30th of September every year for the preceding financial year confirming compliance of the e-commerce guidelines.

Subject to the conditions of FDI policy on services sector and applicable laws/regulations, security and other conditionalities, sale of services through e-commerce will be under automatic route.

### SINGLE BRAND PRODUCT RETAIL TRADING

| Sector/Activities                   | % of Equity/FDI | Entry Route |
|-------------------------------------|-----------------|-------------|
| Single Brand Product Retail Trading | 100%            | Automatic   |

- (1) Foreign Investment in Single Brand product retail trading is aimed at attracting investments in production and marketing, improving the availability of such goods for the consumer, encouraging increased sourcing of goods from India, and enhancing competitiveness of Indian enterprises through access to global designs, technologies and management practices.
- (2) FDI in Single Brand product retail trading would be subject to the following conditions:
  - (a) Products to be sold should be of a 'Single Brand' only.
  - (b) Products should be sold under the same brand internationally i.e. products should be sold under the same brand in one or more countries other than India.

- (c) 'Single Brand' product-retail trading would cover only products which are branded during manufacturing.
- (d) A non-resident entity or entities, whether owner of the brand or otherwise, shall be permitted to undertake 'single brand' product retail trading in the country for the specific brand, either directly by the brand owner or through a legally tenable agreement executed between the Indian entity undertaking single brand retail trading and the brand owner.
- (e) In respect of proposals involving foreign investment beyond 51%, sourcing of 30% of the value of goods purchased, will be done from India, preferably from MSMEs, village and cottage industries, artisans and craftsmen, in all sectors. The quantum of domestic sourcing will be self-certified by the company, to be subsequently checked, by statutory auditors, from the duly certified accounts which the company will be required to maintain. This procurement requirement would have to be met, in the first instance, as an average of five years' total value of the goods procured, beginning 1st April of the year of the commencement of SBRT business (i.e. opening of the first store or start of online retail, whichever is earlier). Thereafter, SBRT entity shall be required to meet the 30% local sourcing norms on an annual basis. For the purpose of ascertaining the sourcing requirement, the relevant entity would be the company, incorporated in India, which is the recipient of foreign investment for the purpose of carrying out single-brand product retail trading.
- (f) For the purpose of meeting local sourcing requirement laid down at para (e) above, all procurements made from India by the SBRT entity for that single brand shall be counted towards local sourcing, irrespective of whether the goods procured are sold in India or exported. SBRT entity is also permitted to set off sourcing of goods from India for global operations against the mandatory sourcing requirement of 30%. For this purpose, 'sourcing of goods from India for global operations' shall mean value of goods sourced from India for global operations for that single brand (in INR terms) in a particular financial year directly by the entity undertaking SBRT or its group companies (resident or non-resident), or indirectly by them through a third party under a legally tenable agreement.
- (g) An SBRT entity operating through brick and mortar stores can also undertake retail trading through e-commerce. However, retail trading through e-commerce can also be undertaken prior to opening of brick and mortar stores, subject to the condition that the entity opens brick and mortar stores within 2 years from date of start of online retail.

Note:

- (i) Conditions mentioned at Para (2) (b) & (2) (d) will not be applicable for undertaking SBRT of Indian brands.
- (ii) Indian brands should be owned and controlled by resident Indian citizens and/or companies which are owned and controlled by resident Indian citizens.
- (iii) Sourcing norms will not be applicable up to three years from commencement of the business i.e. opening of the first store or start of online retail, whichever is earlier for entities undertaking single brand retail trading of products having 'state-of-art' and 'cutting-edge' technology and where local sourcing is not possible. A Committee under the Chairmanship of Secretary, DPIIT, with representatives from NITI Aayog, concerned Administrative Ministry and independent technical expert(s) on the subject will examine the claim of applicants on the issue of the products being in the nature of 'state-of-art' and 'cutting-edge' technology where local sourcing is not possible and give recommendations for such relaxation.

## MULTI BRAND RETAIL TRADING

| Sector/Activities                  | % of Equity/FDI | Entry Route |
|------------------------------------|-----------------|-------------|
| Multi Brand Product Retail Trading | 51%             | Government  |

- (1) FDI in multi brand retail trading, in all products, will be permitted, subject to the following conditions:
  - (i) Fresh agricultural produce, including fruits, vegetables, flowers, grains, pulses, fresh poultry, fishery and meat products, may be unbranded.
  - (ii) Minimum amount to be brought in, as FDI, by the foreign investor, would be US \$ 100 million.
  - (iii) At least 50% of total FDI brought in the first tranche of US \$ 100 million, shall be invested in 'back-end

infrastructure' within three years, where 'back-end infrastructure' will include capital expenditure on all activities, excluding that on front-end units; for instance, back-end infrastructure will include investment made towards processing, manufacturing, distribution, design improvement, quality control, packaging, logistics, storage, ware-house, agriculture market produce infrastructure etc. Expenditure on land cost and rentals, if any, will not be counted for purposes of backend infrastructure. Subsequent investment in backend infrastructure would be made by the MBRT retailer as needed, depending upon its business requirements.

- (iv) At least 30% of the value of procurement of manufactured/processed products purchased shall be sourced from Indian micro, small and medium industries, which have a total investment in plant & machinery not exceeding US \$ 2.00 million. This valuation refers to the value at the time of installation, without providing for depreciation. The 'small industry' status would be reckoned only at the time of first engagement with the retailer, and such industry shall continue to qualify as a 'small industry' for this purpose, even if it outgrows the said investment of US \$ 2.00 million during the course of its relationship with the said retailer. Sourcing from agricultural co-operatives and farmers co-operatives would also be considered in this category. The procurement requirement would have to be met, in the first instance, as an average of five years' total value of the manufactured/processed products purchased, beginning 1st April of the year during which the first tranche of FDI is received. Thereafter, it would have to be met on an annual basis.
  - (v) Self-certification by the company, to ensure compliance of the conditions at serial nos. (ii), (iii) and (iv) above, which could be cross-checked, as and when required. Accordingly, the investors shall maintain accounts, duly certified by statutory auditors.
  - (vi) Government will have the first right to procurement of agricultural products.
  - (vii) The above policy is an enabling policy only and the State Governments/Union Territories would be free to take their own decisions in regard to implementation of the policy. Therefore, retail sales outlets may be set up in those States/Union Territories which have agreed, or agree in future, to allow FDI in MBRT under this policy. The list of States/Union Territories which have conveyed their agreement is at (2) below. Such agreement, in future, to permit establishment of retail outlets under this policy, would be conveyed to the Government of India through the Department for Promotion of Industry and Internal Trade and additions would be made to the list at (2) below accordingly. The establishment of the retail sales outlets will be in compliance of applicable State/Union Territory laws/ regulations, such as the Shops and Establishments Act etc.
  - (viii) Retail trading, in any form, by means of e-commerce, would not be permissible, for companies with FDI, engaged in the activity of multi-brand retail trading.
- (2) List of States/Union Territories as mentioned (viii)
1. Andhra Pradesh
  2. Assam
  3. Delhi
  4. Haryana
  5. Himachal Pradesh
  6. Jammu & Kashmir
  7. Karnataka
  8. Maharashtra
  9. Manipur
  10. Rajasthan
  11. Uttarakhand
  12. Daman & Diu and Dadra and Nagar Haveli (Union Territories)

## DUTY FREE SHOPS

| Sector/Activities | % of Equity/FDI | Entry Route |
|-------------------|-----------------|-------------|
| Duty Free Shop    | 100%            | Automatic   |

- (i) Duty Free Shops would mean shops set up in custom bonded area at International Airports/International Seaports and Land Custom Stations where there is transit of international passengers.
- (ii) Foreign investment in Duty Free Shops is subject to compliance of conditions stipulated under the Customs Act, 1962 and other laws, rules and regulations.
- (iii) Duty Free Shop entity shall not engage into any retail trading activity in the Domestic Tariff Area of the country.

## RAILWAY INFRASTRUCTURE

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| <b>Railway Infrastructure</b><br>Construction, operation and maintenance of the following:<br>(i) Suburban corridor projects through PPP, (ii) High speed train projects, (iii) Dedicated freight lines, (iv) Rolling stock including train sets, and locomotives/coaches manufacturing and maintenance facilities, (v) Railway Electrification, (vi) Signaling systems, (vii) Freight terminals, (viii) Passenger terminals, (ix) Infrastructure in industrial park pertaining to railway line/sidings including electrified railway lines and connectivities to main railway line and (x) Mass Rapid Transport Systems. | 100%            | Automatic   |

*Note:*

- (i) Foreign Direct Investment in the abovementioned activities open to private sector participation including FDI is subject to sectoral guidelines of Ministry of Railways.
- (ii) Proposals involving FDI beyond 49% in sensitive areas from security point of view, will be brought by the Ministry of Railways before the Cabinet Committee on Security (CCS) for consideration on a case to case basis.57

## ASSET RECONSTRUCTION COMPANIES

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Asset Reconstruction Company' (ARC) means a company registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). | 100%            | Automatic   |

### Other Conditions

Persons resident outside India can invest in the capital of Asset Reconstruction Companies (ARCs) registered with Reserve Bank of India, up to 100% on the automatic route.

Investment limit of a sponsor in the shareholding of an ARC will be governed by the provisions of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, as amended from time to time. Similarly, investment by institutional / non-institutional investors will also be governed by the said Act, as amended from time to time.

The total shareholding of an individual FPI shall be below 10% of the total paid-up capital.

FPIs can invest in the Security Receipts (SRs) issued by ARCs. /FPIs may be allowed to invest up to 100 per cent of each tranche in SRs issued by ARCs, subject to directions/guidelines of Reserve Bank of India. Such investment should be within the relevant regulatory cap as applicable.

All investments would be subject to provisions of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, as amended from time to time.

## BANKING- PRIVATE SECTOR

| Sector/Activities       | % of Equity/FDI | Entry Route   |
|-------------------------|-----------------|---|
| Banking- Private Sector | 74%             | Automatic up to 49%<br>Government route beyond 49% and up to 74%. |

### ***Other Conditions***

This 74% limit will include investment under the Portfolio Investment Scheme (PIS) by /FPIs, NRIs and shares acquired prior to September 16, 2003 by erstwhile OCBs, and continue to include IPOs, Private placements, GDR/ADRs and acquisition of shares from existing shareholders.

The aggregate foreign investment in a private bank from all sources will be allowed up to a maximum of 74 per cent of the paid-up capital of the Bank. At all times, at least 26 per cent of the paid-up capital will have to be held by residents, except in regard to a wholly-owned subsidiary of a foreign bank.

The stipulations as above will be applicable to all investments in existing private sector banks also.

Other conditions in respect of permissible limits under portfolio investment schemes through stock exchanges for/ FPIs and NRIs, setting-up of a subsidiary by foreign banks and limits in respect of voting rights.

## BANKING- PUBLIC SECTOR

| Sector/Activities  | % of Equity/FDI | Entry Route |
|--|-----------------|-------------|
| Banking- Public Sector subject to Banking Companies (Acquisition & Transfer of Undertakings) Acts 1970/80. This ceiling (20%) is also applicable to the State Bank of India and its associate Banks. | 20%             | Government  |

## CREDIT INFORMATION COMPANIES (CIC)

| Sector/Activities          | % of Equity/FDI | Entry Route |
|----------------------------|-----------------|-------------|
| Credit Information Company | 100%            | Automatic   |

### ***Other Conditions***

- (1) Foreign investment in Credit Information Companies is subject to the Credit Information Companies (Regulation) Act, 2005.
- (2) Foreign investment is permitted subject to regulatory clearance from RBI.
- (3) Such /FPI investment would be permitted subject to the conditions that:
  - (i) A single entity should directly or indirectly hold below 10% equity.
  - (ii) Any acquisition in excess of 1% will have to be reported to RBI as a mandatory requirement; and
  - (iii) /FPIs investing in CICs shall not seek a representation on the Board of Directors based upon their shareholding.

## INFRASTRUCTURE COMPANY IN THE SECURITIES MARKET

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Infrastructure companies in Securities Markets, namely, stock exchanges, commodity exchanges, depositories and clearing corporations, in compliance with SEBI Regulations | 49%             | Automatic   |

### Other Conditions

Foreign investment, including investment by FPIs, will be subject to the Securities Contracts (Regulations) (Stock Exchanges and Clearing Corporations) Regulations 2012, and Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 as amended from time to time, and other Guidelines/Regulations issued by the Central Government, SEBI and the Reserve Bank of India from time to time.

Words and expressions used herein and not defined in these regulations but defined in the Companies Act, 2013 or the Securities Contracts (Regulation) Act, 1956 or the Securities and Exchange Board of India Act, 1992 or the Depositories Act, 1996 or in the concerned Regulations issued by SEBI shall have the same meanings respectively assigned to them in those Acts/ Regulations.

Futures trading in commodities are regulated under the Forward Contracts (Regulation) Act, 1952. Commodity Exchanges, like Stock Exchanges, are infrastructure companies in the commodity futures market. With a view to infuse globally acceptable best practices, modern management skills and latest technology, it was decided to allow foreign investment in Commodity Exchanges.

It may be noted that:

“Commodity Exchange” is a recognized association under the provisions of the Forward Contracts (Regulation) Act, 1952, as amended from time to time, to provide exchange platform for trading in forward contracts in commodities.

“Recognized association” means an association to which recognition for the time being has been granted by the Central Government under Section 6 of the Forward Contracts (Regulation) Act, 1952

“Association” means any-body of individuals, whether incorporated or not, constituted for the purposes of regulating and controlling the business of the sale or purchase of any goods and commodity derivative.

“Forward contract” means a contract for the delivery of goods and which is not a ready delivery contract.

“Commodity derivative” means a contract for delivery of goods, which is not a ready delivery contract; or a contract for differences which derives its value from prices or indices of prices of such underlying goods or activities, services, rights, interests and events, as may be notified in consultation with SEBI by the Central Government, but does not include securities.

## INSURANCE

| Sector/Activities   | % of Equity/FDI | Entry Route |
|---|-----------------|-------------|
| Insurance Company   | 74 %            | Automatic   |
| <b>Intermediaries or Insurance Intermediaries</b> including insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, Surveyors and Loss Assessors and such other entities, as may be notified by the Insurance Regulatory and Development Authority of India from time to time. | 100%            | Automatic   |

### Other Conditions

- (a) No Indian Insurance company shall allow the aggregate holdings by way of total foreign investment in its equity shares by foreign investors, including portfolio investors, to exceed seventy four percent of the paid-up equity capital of such Indian Insurance company.

- (b) The foreign investment up to seventy four percent of the total paid-up equity of the Indian Insurance Company shall be allowed on the automatic route subject to approval/verification by the Insurance Regulatory and Development Authority of India.
- (c) Foreign investment in this sector shall be subject to compliance with the provisions of the Insurance Act, 1938 and the condition that Companies receiving FDI shall obtain necessary license /approval from the Insurance Regulatory & Development Authority of India for undertaking insurance and related activities.
- (d) An Indian Insurance company having foreign investment-(i) a majority of its Directors; (ii) a Majority of its Key Managerial Persons; and (iii) at list one among the Chairperson of its Board, its MD & its CEO shall be resident Indian citizen.
- (e) Foreign portfolio investment in an Indian Insurance company shall be governed by the provisions contained in Chapter-IV, Rule 10 and 11 read with Schedule II of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 and provisions of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2019.
- (f) Any increase in foreign investment in an Indian Insurance company shall be in accordance with the pricing guidelines specified by Reserve Bank of India under the FEMA Regulations.
- (g) The foreign equity investment cap of 100 percent shall apply on the same terms as above to insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, Surveyors and Loss Assessors and such other entities, as may be notified by the Insurance Regulatory and Development Authority of India from time to time. However, the condition of Indian owned and controlled, as specified in Clause (d) above, shall not be applicable to Intermediaries and Insurance Intermediaries and composition of the Board of Directors and key management persons shall be as specified by the concerned regulators from time to time.
- (h) The foreign direct investment proposals shall be allowed under the automatic route subject to verification by the Authority and the foreign investment in intermediaries or insurance intermediaries shall be governed by the same terms as provided under rules 7 and 8 of the Indian Insurance Companies (Foreign Investment) Rules, 2015, as amended from time to time:

Provided that where an entity like a bank, whose primary business is outside the insurance area, is allowed by the Insurance Regulatory and Development Authority of India to function as an insurance intermediary, the foreign equity investment caps applicable in that sector shall continue to apply, subject to the condition that the revenues of such entities from their primary (i.e., non-insurance related) business must remain above 50 percent of their total revenues in any financial year.

- (i) The insurance intermediary that has majority shareholding of foreign investors shall undertake the following:
  - i. be incorporated as a limited company under the provisions of the Companies Act, 2013;
  - ii. at least one from among the Chairman of the Board of Directors or the Chief Executive Officer or Principal Officer or Managing Director of the insurance intermediary shall be a resident Indian citizen;
  - iii. shall take prior permission of the Authority for repatriating dividend;
  - iv. shall bring in the latest technological, managerial and other skills;
  - v. shall not make payments to the foreign group or promoter or subsidiary or interconnected or associate entities beyond what is necessary or permitted by the Authority;
  - vi. shall make disclosures in the formats to be specified by the Authority of all payments made to its group or promoter or subsidiary or interconnected or associate entities;
  - vii. composition of the Board of Directors and key management persons shall be as specified by the concerned regulators;
- (j) The provisions relating to 'Banking-Private Sector', shall be applicable in respect of bank promoted insurance companies.

- (k) Terms 'Control', 'Equity Share Capital', 'Foreign Direct Investment' (FDI), 'Foreign Investors', 'Foreign Portfolio Investment', 'Indian Insurance Company', 'Indian Company', 'Indian Control of an Indian Insurance Company', 'Indian Ownership', 'Non-resident Entity', 'Public Financial Institution', 'Resident Indian Citizen', 'Total Foreign Investment' will have the same meaning as provided in Notification No. G.S.R 115 (E), dated 19th February, 2015 issued by Department of Financial Services and regulations issued by Insurance Regulatory and Development Authority of India from time to time.

## PENSION SECTOR

| Sector/Activities | % of Equity/FDI | Entry Route |
|-------------------|-----------------|-------------|
| Pension Sector    | 49%             | Automatic   |

- (i) Foreign investment in the Pension Funds is allowed as per the Pension Fund Regulatory and Development Authority (PFRDA) Act, 2013.
- (ii) Foreign Investment in Pension Funds will be subject to the condition that entities bringing in foreign equity investment as per Section 24 of the PFRDA Act shall obtain necessary registration from the Pension Fund Regulatory and Development Authority and comply with other requirements as per the PFRDA Act, 2013 and Rules and Regulations framed under it for so participating in Pension Fund Management activities in India.
- (iii) An Indian pension fund shall ensure that its ownership and control remains at all times in the hands of resident Indian entities as determined by the Government of India/PFRDA as per the rules/regulation issued by them from time to time.

## POWER EXCHANGES

| Sector/Activities  | % of Equity/FDI | Entry Route |
|--|-----------------|-------------|
| Power Exchanges registered under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010. | 49%             | Automatic   |

### Conditions:

- (i) No non-resident investor/entity, including persons acting in concert, will hold more than 5% of the equity in these companies; and
- (ii) The foreign investment would be in compliance with SEBI Regulations; other applicable laws/regulations; security and other conditionalities.

## WHITE LABEL ATM OPERATIONS

| Sector/Activities          | % of Equity/FDI | Entry Route |
|----------------------------|-----------------|-------------|
| White Label ATM Operations | 100%            | Automatic   |

### Conditions

- (i) Any non-bank entity intending to set up WLAs should have a minimum net worth of Rs. 100 crore as per the latest financial year's audited balance sheet, which is to be maintained at all times.
- (ii) In case the entity is also engaged in any 'Other Financial Services', then the foreign investment in the company setting up WLA, shall also have to comply with the minimum capitalization norms, if any, for foreign investments in such 'Other Financial Services'.
- (iii) FDI in the WLAO will be subject to the specific criteria and guidelines issued by RBI vide Circular No. DPSS. CO.PD.No. 2298/02.10.002/2011-2012, as amended from time to time.

## OTHER FINANCIAL SERVICES

| Sector/Activities  | % of Equity/FDI | Entry Route |
|--|-----------------|-------------|
| Financial Services activities regulated by financial sector regulators, viz., RBI, SEBI, IRDA, PFRDA, NHB or any other financial sector regulator as may be notified by the Government of India. | 100%            | Automatic   |

### Conditions

- (i) Foreign investment in 'Other Financial Services' activities shall be subject to conditionalities, including minimum capitalization norms, as specified by the concerned Regulator/Government Agency.
- (ii) 'Other Financial Services' activities need to be regulated by one of the Financial Sector Regulators. In all such financial services activity which are not regulated by any Financial Sector Regulator or where only part of the financial services activity is regulated or where there is doubt regarding the regulatory oversight, foreign investment up to 100% will be allowed under Government approval route subject to conditions including minimum capitalization as may be decided by the Government.
- (iii) Any activity which is specifically regulated by an Act, the foreign investment limits will be restricted to those levels/limit that may be specified in that Act, if so mentioned.
- (iv) Downstream investments by any of these entities engaged in "Other Financial Services" will be subject to the extant sectoral regulations and provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2000, as amended from time to time.

## PHARMACEUTICALS

| Sector/Activities | % of Equity/FDI | Entry Route  |
|-------------------|-----------------|--|
| Greenfield        | 100%            | Automatic  |
| Brownfield        |                 | Automatic up to 74%<br>Government route beyond 74% |

### Other Conditions

- (i) 'Non-compete' clause would not be allowed in automatic or government approval route except in special circumstances with the approval of the Government.
- (ii) The prospective investor and the prospective investee are required to provide a certificate along with the application for foreign investment.
- (iii) Government may incorporate appropriate conditions for FDI in brownfield cases, at the time of granting approval.
- (iv) FDI in brownfield pharmaceuticals, under both automatic and government approval routes, is further subject to compliance of following conditions:
  - (a) The production level of National List of Essential Medicines (NLEM) drugs and/or consumables and their supply to the domestic market at the time of induction of FDI, being maintained over the next five years at an absolute quantitative level. The benchmark for this level would be decided with reference to the level of production of NLEM drugs and/or consumables in the three financial years, immediately preceding the year of induction of FDI. Of these, the highest level of production in any of these three years would be taken as the level.
  - (b) R&D expenses being maintained in value terms for 5 years at an absolute quantitative level at the time of induction of FDI. The benchmark for this level would be decided with reference to the highest level of R&D expenses which has been incurred in any of the three financial years immediately preceding the year of induction of FDI.
  - (c) The administrative Ministry will be provided complete information pertaining to the transfer of technology, if any, along with induction of foreign investment into the investee company.

- (d) The administrative Ministry(s) i.e. Ministry of Health and Family Welfare, Department of Pharmaceuticals or any other regulatory Agency/Development as notified by Central Government from time to time, will monitor the compliance of conditionalities.

Note:

- i. FDI up to 100%, under the automatic route is permitted for manufacturing of medical devices. The above mentioned conditions will, therefore, not be applicable to greenfield as well as brownfield projects of this industry.
- ii. Medical device means -
  - (a) any instrument, apparatus, appliance, implant, material or other article, whether used alone or in combination, including the software, intended by its manufacturer to be used specially for human beings or animals for one or more of the specific purposes of -
    - i. diagnosis, prevention, monitoring, treatment or alleviation of any disease or disorder;
    - ii. diagnosis, monitoring, treatment, alleviation or assistance for, any injury or disability;
    - iii. investigation, replacement or modification or support of the anatomy or of a physiological process;
    - iv. supporting or sustaining life;
    - v. disinfection of medical devices;
    - vi. control of conception,
    - vii. and which does not achieve primary intended action in or on the human body or animals by any pharmacological or immunological or metabolic means, but which may be assisted in its intended function by such means;
  - (b) an accessory to such an instrument, apparatus, appliance, material or other article;
  - (c) in-vitro diagnostic device which is a reagent, reagent product, calibrator, control material, kit, instrument, apparatus, equipment or system, whether used alone or in combination thereof intended to be used for examination and providing information for medical or diagnostic purposes by means of examination of specimens derived from the human bodies or animals.

## TYPES OF INSTRUMENTS

1. Indian companies can issue equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares subject to pricing guidelines/valuation norms prescribed under FEMA Regulations. The price/conversion formula of convertible capital instruments should be determined upfront at the time of issue of the instruments. The price at the time of conversion should not in any case be lower than the fair value worked out, at the time of issuance of such instruments, in accordance with the extant FEMA rules/regulations [as per any internationally accepted pricing methodology on arm's length basis for the unlisted companies and valuation in terms of SEBI (ICDR) Regulations, for the listed companies].
- 1.1 Optionality clauses are allowed in equity shares, fully, compulsorily and mandatorily convertible debentures and fully, compulsorily and mandatorily convertible preference shares under FDI scheme, subject to the following conditions:
  - (a) There is a minimum lock-in period of one year which shall be effective from the date of allotment of such capital instruments.
  - (b) After the lock-in period and subject to FDI Policy provisions, if any, the non-resident investor exercising option/right shall be eligible to exit without any assured return, as per pricing/valuation guidelines issued under FEMA from time to time.
2. Other types of Preference shares/Debentures i.e. non-convertible, optionally convertible or partially convertible for issue of which funds have been received on or after May 1, 2007 are considered as debt. Accordingly, all norms applicable for ECBs relating to eligible borrowers, recognized lenders, amount and

maturity, end-use stipulations, etc. shall apply. Since these instruments would be denominated in rupees, the rupee interest rate will be based on the swap equivalent of London Interbank Offered Rate (LIBOR) plus the spread as permissible for ECBs of corresponding maturity.

3. The inward remittance received by the Indian company vide issuance of DRs and FCCBs are treated as FDI and counted towards FDI.
4. **Acquisition of Warrants and Partly Paid Shares** - An Indian Company may issue warrants and partly paid shares to a person resident outside India subject to terms and conditions as stipulated by the Reserve Bank of India in this behalf, from time to time.

#### 5. Issue of Foreign Currency Convertible Bonds (FCCBs) and Depository Receipts (DRs)

- a) FCCBs/DRs may be issued in accordance with the Scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and DR Scheme 2014 respectively, as per the guidelines issued by the Government of India there under from time to time.
  - b) DRs are foreign currency denominated instruments issued by a foreign Depository in a permissible jurisdiction against a pool of permissible securities issued or transferred to that foreign depository and deposited with a domestic custodian.
  - c) In terms of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 as amended from time to time, a person will be eligible to issue or transfer eligible securities to a foreign depository, for the purpose of converting the securities so purchased into depository receipts in terms of Depository Receipts Scheme, 2014 and guidelines issued by the Government of India thereunder from time to time.
  - d) A person can issue DRs, if it is eligible to issue eligible instruments to person resident outside India under relevant Schedules under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, as amended from time to time.
  - e) The aggregate of eligible securities which may be issued or transferred to foreign depositories, along with eligible securities already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible securities under the relevant regulations framed under FEMA, 1999.
  - f) The pricing of eligible securities to be issued or transferred to a foreign depository for the purpose of issuing depository receipts should not be at a price less than the price applicable to a corresponding mode of issue or transfer of such securities to domestic investors under the relevant regulations framed under FEMA, 1999.
  - g) The issue of depository receipts as per DR Scheme 2014 shall be reported to the Reserve Bank by the domestic custodian as per the reporting guidelines for DR Scheme 2014.
6. (i) **Two-way Fungibility Scheme:** A limited two-way Fungibility scheme has been put in place by the Government of India for ADRs/GDRs. Under this Scheme, a stock broker in India, registered with SEBI, can purchase shares of an Indian company from the market for conversion into ADRs/GDRs based on instructions received from overseas investors. Re-issuance of ADRs/GDRs would be permitted to the extent of ADRs/GDRs which have been redeemed into underlying shares and sold in the Indian market.
  - (ii) **Sponsored ADR/GDR issue:** An Indian Company can also sponsor an issue of ADR/GDR. Under this mechanism, the company offers its resident shareholders a choice to submit their shares back to the company so that on the basis of such shares, ADRs/GDRs can be issued abroad. The proceeds of the ADR/GDR issue are remitted back to India and distributed among the resident investors who had offered their Rupee denominated shares for conversion. These proceeds can be kept in Resident Foreign Currency (Domestic) accounts in India by the resident shareholders who have tendered such shares for conversion into ADRs/GDRs.

## PROVISIONS RELATING TO ISSUE/ TRANSFER OF SHARES

1. The capital instruments should be issued within 60 days from the date of receipt of the inward remittance received through normal banking channels including escrow account opened and maintained for the purpose or by debit to the NRE/FCNR (B) account of the non-resident investor. In case, the capital instruments are not issued within 60 days from the date of receipt of the inward remittance or date of debit to the NRE/FCNR (B) account, the amount of consideration so received should be refunded within fifteen days from the date of completion of sixty days to the non-resident investor by outward remittance through normal banking channels or by credit to the NRE/FCNR (B) account, as the case may be. Non-compliance with the above provision would be reckoned as a contravention under FEMA and would attract penal provisions. In exceptional cases, delay in refund of the amount of consideration may be considered by the RBI, on the merits of the case.

### 2. Issue price of shares

Price of shares issued to persons resident outside India under the FDI Policy, shall not be less than –

- a. the price worked out in accordance with the SEBI guidelines, as applicable, where the shares of the company are listed on any recognised stock exchange in India;
- b. the fair valuation of shares done by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis, where the shares of the company are not listed on any recognised stock exchange in India; and
- c. the price as applicable to transfer of shares from resident to non-resident as per the pricing guidelines laid down by the Reserve Bank from time to time, where the issue of shares is on preferential allotment.

However, where non-residents (including NRIs) are making investments in an Indian company in compliance with the provisions of the Companies Act, as applicable, by way of subscription to its Memorandum of Association, such investments may be made at face value subject to their eligibility to invest under the FDI scheme.

### 3. Foreign Currency Account

Indian companies which are eligible to issue shares to persons resident outside India under the FDI Policy may be allowed to retain the share subscription amount in a Foreign Currency Account, in accordance with RBI guidelines..

### 4. Transfer of shares and convertible debentures

- (i) Subject to FDI sectoral policy (relating to sectoral caps and entry routes), applicable laws and other conditionality's including security conditions, non-resident investors can also invest in Indian companies by purchasing/acquiring existing shares from Indian shareholders or from other non-resident shareholders. General permission has been granted to non-residents/NRIs for acquisition of shares by way of transfer subject to the following:
  - (a) A person resident outside India (other than NRI and erstwhile OCB) may transfer by way of sale or gift, the shares or convertible debentures to any person resident outside India (including NRIs). Government approval is not required for transfer of shares in the investee company from one non-resident to another non-resident in sectors which are under automatic route. In addition, approval of Government will be required for transfer of stake from one non-resident to another non-resident in sectors which are under Government approval route.
  - (b) NRIs may transfer by way of sale or gift the shares or convertible debentures held by them to another NRI.
  - (c) A person resident outside India can transfer any security to a person resident in India by way of gift.
  - (d) A person resident outside India can sell the shares and convertible debentures of an Indian company on a recognized Stock Exchange in India through a stock broker registered with stock exchange or a merchant banker registered with SEBI.

- (e) A person resident in India can transfer by way of sale, shares/ convertible debentures (including transfer of subscriber's shares), of an Indian company under private arrangement to a person resident outside India, subject to the guidelines.
- (f) General permission is also available for transfer of shares/convertible debentures, by way of sale under private arrangement by a person resident outside India to a person resident in India, subject to the guidelines.
- (g) The above General Permission also covers transfer by a resident to a non-resident of shares/ convertible debentures of an Indian company, engaged in an activity earlier covered under the Government Route but now falling under Automatic Route, as well as transfer of shares by a non-resident to an Indian company under buyback and/or capital reduction scheme of the company.
- (h) The Form FC-TRS should be submitted to the AD Category-I Bank, within 60 days of transfer of capital instruments or receipt / remittance of funds whichever is earlier. The onus of submission of the Form FC-TRS within the given timeframe would be on the resident transferor/transferee or the person resident outside India holding capital instruments on a non-repatriable basis, as the case may be. Transfer of equity instruments on a recognised stock exchange by a person resident outside India shall be reported by such person in Form FC-TRS. However, in cases where the NR investor, including an NRI, acquires shares on the stock exchanges under the FDI scheme, the person resident outside India would have to file form FC-TRS with the AD Category-I bank.
- (ii) The sale consideration in respect of equity instruments purchased by a person resident outside India, remitted into India through normal banking channels, shall be subjected to a Know Your Customer (KYC) check by the remittance receiving AD Category-I bank at the time of receipt of funds. In case, the remittance receiving AD Category-I bank is different from the AD Category-I bank handling the transfer transaction, the KYC check should be carried out by the remittance receiving bank and the KYC report be submitted by the customer to the AD Category-I bank carrying out the transaction along with the Form FC-TRS.
- (iii) A person resident outside India including a Non-Resident Indian investor who has already acquired and continues to hold the control in accordance with the SEBI (Substantial Acquisition of Shares and Takeover) Regulations can acquire shares of a listed Indian company on the stock exchange through a registered broker under FDI scheme provided that the original and resultant investments are in line with the extant FDI policy and FEMA regulations in respect of sectoral cap, entry route, mode of payment, reporting requirement, documentation, etc.
- (iv) **Escrow:** AD Category-I banks have been given general permission to open Escrow account and Special account of non-resident corporate for open offers/exit offers and delisting of shares. The relevant SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (SAST) Regulations or any other applicable SEBI Regulations/provisions of the Companies Act, as applicable will be applicable. AD Category-I banks have also been permitted to open and maintain, without prior approval of RBI, non-interest bearing Escrow accounts in Indian Rupees in India on behalf of residents and/or non-residents, towards payment of share purchase consideration and/or provide Escrow facilities for keeping securities to facilitate FDI transactions subject to the terms and conditions specified by RBI. SEBI authorised Depository Participants have also been permitted to open and maintain, without prior approval of RBI, Escrow accounts for securities subject to the terms and conditions as specified by RBI. In both cases, the Escrow agent shall necessarily be an AD Category-I bank or SEBI authorised Depository Participant (in case of securities' accounts). These facilities will be applicable for both issue of fresh shares to the non-residents as well as transfer of shares from/to the non-residents.
- (v) In case of transfer of shares between a resident buyer and a non-resident seller or vice-versa, not more than twenty five per cent of the total consideration can be paid by the buyer on a deferred basis within a period not exceeding eighteen months from the date of the transfer agreement. For this purpose, if so agreed between the buyer and the seller, an escrow arrangement may be made between the buyer and the seller for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the transfer agreement or if the total consideration is paid

by the buyer to the seller, the seller may furnish an indemnity for an amount not more than twenty five per cent of the total consideration for a period not exceeding eighteen months from the date of the payment of the full consideration.

Provided the total consideration finally paid for the shares must be compliant with the applicable pricing guidelines.

## 5. Prior permission of RBI in certain cases for transfer of capital instruments

### 5.1 Except cases mentioned in paragraph 5.2 below, the following cases require prior approval of RBI:

- (i) Transfer of capital instruments from resident to non-residents by way of sale where:
  - (a) Transfer is at a price which falls outside the pricing guidelines prescribed under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 from time to time and the transaction does not fall under the exception given in para 5.2.
  - (b) Transfer of capital instruments by the non-resident acquirer involving deferment of payment of the amount of consideration. Further, in case approval is granted for a transaction, the same should be reported in Form FC-TRS, to an AD Category-I bank for necessary due diligence, within 60 days from the date of receipt of the full and final amount of consideration.
- (ii) Transfer of any capital instrument, by way of gift by a person resident in India to a person resident outside India. While forwarding applications to Reserve Bank for approval for transfer of capital instruments by way of gift, the documents mentioned in Section 2 below should be enclosed. Reserve Bank considers the following factors while processing such applications:
  - (a) The proposed transferee (donee) is eligible to hold such capital instruments under the relevant Schedules under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019, as amended from time to time.
  - (b) The gift does not exceed 5 per cent of the paid-up capital of the Indian company/each series of debentures/each mutual fund scheme.
  - (c) The applicable sectoral cap limit in the Indian company is not breached.
  - (d) The transferor (donor) and the proposed transferee (donee) are close relatives as defined in Section 2 (77) of Companies Act, 2013, as amended from time to time.
  - (e) The value of capital instruments to be transferred together with any capital instruments already transferred by the transferor, as gift, to any person residing outside India does not exceed the rupee equivalent of USD 50,000 during the financial year.
  - (f) Such other conditions as stipulated by Reserve Bank in public interest from time to time.
- (iii) Transfer of shares from NRI to non-resident.

### 5.2 In the following cases, approval of RBI is not required:

#### A. Transfer of shares from a Non-Resident to Resident under the FDI scheme where the pricing guidelines under FEMA, 1999 are not met provided that:

- (i) The original and resultant investment are in line with the extant FDI policy and FEMA regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation, etc.;
- (ii) The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations/guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/substantial acquisition/SEBI SAST, buy back); and
- (iii) Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations/guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.

**B. Transfer of shares from Resident to Non-Resident:**

- (i) **where the transfer of shares requires the prior approval of the Government as per the extant FDI policy provided that:**
  - (a) the requisite approval of the Government has been obtained; and
  - (b) the transfer of shares adheres with the pricing guidelines and documentation requirements as specified by the Reserve Bank of India from time to time.
- (ii) **where the transfer of shares attract SEBI (SAST) Regulations** subject to the adherence with the pricing guidelines and documentation requirements as specified by Reserve Bank of India from time to time.
- (iii) **where the transfer of shares does not meet the pricing guidelines under the FEMA, 1999 provided that:**
  - (a) The resultant FDI is in compliance with the extant FDI policy and FEMA rules/regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, etc.), reporting requirements, documentation etc.;
  - (b) The pricing for the transaction is compliant with the specific/explicit, extant and relevant SEBI regulations/guidelines (such as IPO, Book building, block deals, delisting, exit, open offer/ substantial acquisition/SEBI SAST); and
  - (c) Chartered Accountants Certificate to the effect that compliance with the relevant SEBI regulations/ guidelines as indicated above is attached to the form FC-TRS to be filed with the AD bank.
- (iv) **where the investee company is in the financial sector provided that:**
  - (a) Any 'fit and proper/due diligence' requirements as regards the non-resident investor as stipulated by the respective financial sector regulator, from time to time, have been complied with; and
  - (b) The FDI policy and FEMA rules/regulations in terms of sectoral caps, conditionalities (such as minimum capitalization, pricing, etc.), reporting requirements, documentation etc., are complied with.

**6. Conversion of ECB/Lump sum Fee/Royalty etc. into Equity**

- (i) Indian companies have been granted general permission for conversion of External Commercial Borrowings (ECB) (excluding those deemed as ECB) in convertible foreign currency into equity shares/ fully compulsorily and mandatorily convertible preference shares, subject to the following conditions and reporting requirements:
  - (a) The activity of the company is covered under the Automatic Route for FDI or the company has obtained Government approval for foreign equity in the company;
  - (b) The foreign equity after conversion of ECB into equity is within the sectoral cap, if any;
  - (c) Pricing of shares is as per the provision of para 2 above;
  - (d) Compliance with the requirements prescribed under any other statute and regulation in force; and
  - (e) The conversion facility is available for ECBs availed under the Automatic or Government Route and is applicable to ECBs, due for payment or not, as well as secured/unsecured loans availed from non-resident collaborators.
- (ii) General permission is also available for issue of shares/preference shares against lump sum technical know-how fee, royalty due for payment, subject to entry route, sectoral cap and pricing guidelines and compliance with applicable tax laws. Further, issue of equity shares against any other funds payable by the investee company, remittance of which does not require prior permission of the Government of India or Reserve Bank of India under FEMA, 1999 or any rules/ regulations framed or directions issued thereunder, or has been permitted by the Reserve Bank under the Act or the rules and regulations framed or directions issued thereunder is permitted, provided that:

- (a) The equity shares shall be issued in accordance with the extant FDI guidelines on sectoral caps, pricing guidelines etc. as amended by Reserve bank of India, from time to time;
 

Explanation: Issue of shares/convertible debentures that require Government approval in terms of paragraph 3 of Schedule I of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 or import dues deemed as ECB or trade credit or payable against import of second hand machinery shall continue to be dealt in accordance with extant guidelines;
- (b) The issue of equity shares under this provision shall be subject to tax laws as applicable to the funds payable and the conversion to equity should be net of applicable taxes.
- (c) A wholly owned subsidiary set up in India by a non-resident entity, operating in a sector where 100 percent foreign investment is allowed in the automatic route and there are no FDI linked conditionalities, may issue equity shares or preference shares or convertible debentures or warrants to the said non-resident entity against pre-incorporation/ pre-operative expenses incurred by the said non-resident entity up to a limit of five percent of its capital or USD 500,000 whichever is less, subject to the condition that within thirty days from the date of issue of equity instruments but not later than one year from the date of incorporation or such time as the Reserve Bank permits, the Indian company shall report the transaction to the Reserve Bank as per the reporting requirements as specified by the Reserve Bank..
- (d) Issue of equity shares for sectors requiring Government approval under the FDI policy is allowed under the Government route for the following:
  - (I) import of capital goods/ machinery/ equipment (excluding second-hand machinery), subject to compliance with the following conditions:
    - (a) Any import of capital goods/machinery etc., made by a resident in India, has to be in accordance with the Export/Import Policy issued by Government of India/as defined by DGFT/FEMA provisions relating to imports.
    - (b) The application clearly indicating the beneficial ownership and identity of the Importer Company as well as overseas entity.
    - (c) Applications complete in all respects, for conversions of import payables for capital goods into FDI being made within 180 days from the date of shipment of goods.
  - (II) pre-operative/pre-incorporation expenses (including payments of rent etc.), subject to compliance with the following conditions:
    - (a) Submission of FIRC for remittance of funds by the overseas promoters for the expenditure incurred.
    - (b) Verification and certification of the pre-incorporation/pre-operative expenses by the statutory auditor.
    - (c) Payments should be made by the foreign investor to the company directly or through the bank account opened by the foreign investor as provided under FEMA Regulations.
    - (d) The applications, complete in all respects, for capitalization being made within the period of 180 days from the date of incorporation of the company.

**General conditions:**

- (i) All requests for conversion should be accompanied by a special resolution of the company.
- (ii) Government's approval would be subject to applicable pricing guidelines under FEMA and appropriate tax clearance.
- (iii) For sectors under automatic route, issue of equity shares against import of capital goods/ machinery/ equipment (excluding second-hand machinery) and pre-operative/pre-incorporation expenses (including payments of rent etc.) is permitted under automatic route subject to compliance with respective conditions mentioned above, and reporting to RBI in form FC-GPR as per procedure prescribed under the FDI policy.

## TERMS AND CONDITIONS FOR TRANSFER OF SHARES/CONVERTIBLE DEBENTURES, BY WAY OF SALE, FROM A PERSON RESIDENT IN INDIA TO A PERSON RESIDENT OUTSIDE INDIA AND FROM A PERSON RESIDENT OUTSIDE INDIA TO A PERSON RESIDENT IN INDIA

**1.1** In order to address the concerns relating to pricing, documentation, payment/ receipt and remittance in respect of the shares/convertible debentures of an Indian company, in all sectors, transferred by way of sale, the parties involved in the transaction shall comply with the guidelines set out below.

**1.2 Parties involved in the transaction are**(a) seller (resident/non-resident), (b) buyer (resident/non-resident), (c) duly authorized agent/s of the seller and/or buyer, (d) Authorised Dealer bank (AD) branch and (e) Indian company, for recording the transfer of ownership in its books.

### 2. Pricing Guidelines

**2.1** The under noted pricing guidelines are applicable to the following types of transactions:

- (i) Transfer of shares by way of sale under private arrangement by a person resident in India to a person resident outside India.
- (ii) Transfer of shares by way of sale under private arrangement by a person resident outside India to a person resident in India.
- (ii) Exit by non-resident investor on exercising option/right in shares or compulsorily & mandatorily convertible preference shares or fully, compulsorily & mandatorily convertible debentures.

**2.2 Transfer by Resident to Non-resident** (i.e. to foreign national, NRI, , FPI and incorporated non-resident entity other than erstwhile OCB) Price of shares transferred by way of sale by resident to a non-resident where the shares of an Indian company are:

- (a) listed on a recognized stock exchange in India ,shall not be less than the price at which the preferential allotment of shares can be made under the SEBI guidelines , as applicable, provided the same is determined for such duration as specified therein, preceding the relevant date, which shall be the date of purchase or sale of shares,
- (b) not listed on a recognized stock exchange in India, shall not be less than the fair value to be determined by a SEBI registered Merchant Banker or a Chartered Accountant as per any internationally accepted pricing methodology on arm's length basis. The price per share arrived at should be certified by a SEBI registered Merchant Banker or a Chartered Accountant.

**2.3 Transfer by Non-resident** (i.e. by incorporated non-resident entity, erstwhile OCB, foreign national, NRI, FPI) **to Resident** Sale of shares by a non-resident to resident shall be in accordance with the provisions of Rule 9 of Foreign Exchange Management (Non-Debt Instruments) Rules, 2019which shall not be more than the minimum price at which the transfer of shares can be made from a resident to a non-resident as given at para 2.2 above.

**2.4** After the lock-in period, as applicable above, and subject to FDI Policy provisions, if any, in this regard, the non-resident investor exercising option/right in shares or convertible debentures issued under FDI Scheme shall be eligible to exit without any assured return, as per pricing/valuation guidelines issued by RBI from time to time.

### 3. Responsibilities / Obligations of the parties

All the parties involved in the transaction would have the responsibility to ensure that the relevant rules/regulations under FEMA are complied with and consequent on transfer of shares, the relevant individual limit/sectoral caps/ foreign equity participation ceilings as fixed by Government are not breached. Settlement of transactions will be subject to payment of applicable taxes, if any.

### 4. Method of payment and remittance/credit of sale proceeds

**4.1** The sale consideration in respect of the shares purchased by a person resident outside India shall be remitted to India through normal banking channels. In case the buyer is a, FPI, payment should be made by debit to its Special Non-Resident Rupee Account. In case the buyer is an NRI, the payment may be made by way of debit to his NRE/FCNR (B) accounts. However, if the shares are acquired on non-repatriation basis by NRI, the

consideration shall be remitted to India through normal banking channel or paid out of funds held in NRE/FCNR (B)/NRO accounts.

4.2. The sale proceeds of shares (net of taxes) sold by a person resident outside India may be remitted outside India. In case of FPI, the sale proceeds may be credited to its foreign currency account or special Non-Resident Rupee Account. In case of NRI, if the shares sold were held on repatriation basis, the sale proceeds (net of taxes) may be credited to his NRE /FCNR(B) accounts and if the shares sold were held on non-repatriation basis, the sale proceeds may be credited to his NRO account subject to payment of taxes.

4.3 The sale proceeds of shares (net of taxes) sold by an OCB may be remitted outside India directly if the shares were held on repatriation basis and if the shares sold were held on non-repatriation basis, the sale proceeds may be credited to its NRO (Current) Account subject to payment of taxes, except in the case of OCBs whose accounts have been blocked by Reserve Bank.

## 5. Documentation

Besides obtaining a declaration in the enclosed Form FC-TRS (in quadruplicate), the AD branch should arrange to obtain and keep on record the following documents:

### 5.1. For sale of shares by a person resident in India

- (i) Consent Letter duly signed by the seller and buyer or their duly appointed agent indicating the details of transfer i.e. number of shares to be transferred, the name of the investee company whose shares are being transferred and the price at which shares are being transferred. In case there is no formal Sale Agreement, letters exchanged to this effect may be kept on record.
- (ii) Where Consent Letter has been signed by their duly appointed agent, the Power of Attorney Document executed by the seller/buyer authorizing the agent to purchase/sell shares.
- (iii) The shareholding pattern of the investee company after the acquisition of shares by a person resident outside India showing equity participation of residents and non-residents category-wise (i.e. NRIs/OCBs/foreign nationals/incorporated non-resident entities/, FPIs) and its percentage of paid up capital obtained by the seller/buyer or their duly appointed agent from the company, where the sectoral cap/limits have been prescribed.
- (iv) Certificate indicating fair value of shares from a Chartered Accountant.
- (v) Copy of Broker's note if sale is made on Stock Exchange
- (vi) Undertaking from the buyer to the effect that he is eligible to acquire shares/convertible debentures under FDI policy and the existing sectoral limits and Pricing Guidelines have been complied with.
- (vii) Undertaking from the /sub account to the effect that the individual / Sub account ceiling as prescribed by SEBI has not been breached, till it gets registered as FPI.

### 5.2. For sale of shares by a person resident outside India

- (i) Consent Letter duly signed by the seller and buyer or their duly appointed agent indicating the details of transfer i.e. number of shares to be transferred, the name of the investee company whose shares are being transferred and the price at which shares are being transferred.
- (ii) Where the Consent Letter has been signed by their duly appointed agent the Power of Attorney Document authorizing the agent to purchase/sell shares by the seller/buyer. In case there is no formal Sale Agreement, letters exchanged to this effect may be kept on record.
- (iii) If the sellers are NRIs/OCBs, the copies of RBI approvals evidencing the shares held by them on repatriation/ non-repatriation basis. The sale proceeds shall be credited NRE/NRO account, as applicable.
- (iv) Certificate indicating fair value of shares from a Chartered Accountant.
- (v) No Objection / Tax Clearance Certificate from Income Tax authority/Chartered Account.
- (vi) Undertaking from the buyer to the effect that the Pricing Guidelines have been adhered to.

## 6. Reporting requirements

6.1 Reporting of transfer of shares between residents and non-residents and vice versa is to be done in Form FC-TRS. The Form FC-TRS should be submitted to the AD Category-I bank, within 60 days of transfer of capital instruments or the date of receipt of the amount of consideration, whichever is earlier. The onus of reporting shall be on the resident transferor / transferee or the person resident outside India holding equity instruments on a non-repatriable basis, as the case may be. The AD Category-I bank, would forward the same to its link office. The link office would consolidate the Forms and submit a monthly report to the Reserve Bank3.

For the purpose the Authorized Dealers may designate branches to specifically handle such transactions. These branches could be staffed with adequately trained staff for this purpose to ensure that the transactions are put through smoothly. The ADs may also designate a nodal office to coordinate the work at these branches and also ensure the reporting of these transactions to the Reserve Bank.

6.2 When the transfer is on private arrangement basis, on settlement of the transactions, the transferee/his duly appointed agent should approach the investee company to record the transfer in their books along with the certificate in the Form FC-TRS from the AD branch that the remittances have been received by the transferor/ payment has been made by the transferee. On receipt of the certificate from the AD, the company may record the transfer in its books.

6.3 The actual inflows and outflows on account of such transfer of shares shall be reported by the AD branch in the R-returns in the normal course.

6.4 In addition the AD branch should submit two copies of the Form FC-TRS received from their constituents/ customers together with the statement of inflows/outflows on account of remittances received/made in connection with transfer of shares, by way of sale, to IBD/FED/or the nodal office designated for the purpose by the bank in the enclosed proforma (which is to be prepared in MS-Excel format). The IBD/FED or the nodal office of the bank will in turn submit a consolidated monthly statement in respect of all the transactions reported by their branches together with copies of the FC-TRS Forms received from their branches to Foreign Exchange Department, Reserve Bank, Foreign Investment Division, Central Office, Mumbai in soft copy (in MS- Excel) by e-mail to fdidata@rbi.org.in

6.5 Shares purchased / sold by /FPIs under private arrangement will be by debit /credit to their Special Non-Resident Rupee Account. Therefore, the transaction should **also** be reported in Form LEC by the designated bank of the /FPI concerned.

6.6 Shares/convertible debentures of Indian companies purchased under Portfolio Investment Scheme by NRIs, OCBs cannot be transferred, by way of sale under private arrangement.

6.7 On receipt of statements from the AD, the Reserve Bank may call for such additional details or give such directions as required from the transferor/transferee or their agents, if need be.

### DOCUMENTS TO BE SUBMITTED BY A PERSON RESIDENT IN INDIA FOR TRANSFER OF SHARES TO A PERSON RESIDENT OUTSIDE INDIA BY WAY OF GIFT:

- i. Name and address of the transferor (donor) and the transferee (donee).
- ii. Relationship between the transferor and the transferee.
- iii. Reasons for making the gift.
- iv. In case of Government dated securities and treasury bills and bonds, a certificate issued by a Chartered Accountant on the market value of such security.
- v. In case of units of domestic mutual funds and units of Money Market Mutual Funds, a certificate from the issuer on the Net Asset Value of such security.
- vi. In case of shares and convertible debentures, a certificate from a Chartered Accountant on the value of such securities according to the guidelines issued by Securities & Exchange Board of India or as per any internationally accepted pricing methodology on arm's length basis for listed companies and unlisted companies, respectively.

- vii. Certificate from the concerned Indian company certifying that the proposed transfer of shares/convertible debentures by way of gift from resident to the non-resident shall not breach the applicable sectoral cap/ FDI limit in the company and that the proposed number of shares/convertible debentures to be held by the non-resident transferee shall not exceed 5 per cent of the paid up capital of the company.
- viii. An undertaking from the resident transferor that the value of security to be transferred together with any security already transferred by the transferor, as gift, to any person residing outside India does not exceed the rupee equivalent of USD 50,000 **during a financial year\***.
- \*RBI's A.P. (DIR Series) Circular No. 14 Dated 15.09.2011
- ix. A declaration from the donee accepting partly paid shares or warrants that donee is aware of the liability as regards calls in arrear and consequences thereof.

## SPECIFIC CONDITIONS IN CERTAIN CASES

### Issue of Rights/Bonus Shares

FEMA provisions allow Indian companies to freely issue Rights/Bonus shares to existing non-resident shareholders, subject to adherence to sectoral cap, if any. However, such issue of bonus/rights shares has to be in accordance with other laws/statutes like the Companies Act, as applicable, SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009 (in case of listed companies), etc. The offer on right basis to the persons resident outside India shall be:

- (i) in the case of shares of a company listed on a recognized stock exchange in India, at a price as determined by the company;
- (ii) in the case of shares of a company not listed on a recognized stock exchange in India, at a price which is not less than the price at which the offer on right basis is made to resident shareholders.

### Prior permission of RBI for Rights issue to erstwhile OCBs

OCBs have been de-recognised as a class of investors from September 16, 2003. Therefore, companies desiring to issue rights share to such erstwhile OCBs will have to take specific prior permission from RBI. As such, entitlement of rights share is not automatically available to erstwhile OCBs. However, bonus shares can be issued to erstwhile OCBs without the approval of RBI.

### Additional allocation of rights share by residents to non-residents

Existing non-resident shareholders are allowed to apply for issue of additional shares/fully, compulsorily and mandatorily convertible debentures/fully, compulsorily and mandatorily convertible preference shares over and above their rights share entitlements. The investee company can allot the additional rights share out of unsubscribed portion, subject to the condition that the overall issue of shares to non-residents in the total paid-up capital of the company does not exceed the sectoral cap.

### Acquisition of shares under Scheme of Merger/Demerger/Amalgamation

Mergers/demergers/ amalgamations of companies in India are usually governed by an order issued by a competent Court on the basis of the Scheme submitted by the companies undergoing merger/demergers/amalgamation. Once the scheme of merger or demerger or amalgamation of two or more Indian companies has been approved by a Court in India, the transferee company or new company is allowed to issue shares to the shareholders of the transferor company resident outside India, subject to the conditions that:

- (i) the percentage of shareholding of persons resident outside India in the transferee or new company does not exceed the sectoral cap, and
- (ii) the transferor company or the transferee or the new company is not engaged in activities which are prohibited under the FDI policy.

**Note:** Government approval would not be required in case of mergers and acquisitions taking place in sectors under automatic route.

## Issue of Non-convertible/redeemable bonus preference shares or debentures

Indian companies are allowed to issue non-convertible/redeemable preference shares or debentures to non-resident shareholders, including the depositories that act as trustees for the ADR/GDR holders, by way of distribution as bonus from its general reserves under a Scheme of Arrangement approved by a Court in India under the provisions of the Companies Act, as applicable, subject to no-objection from the Income Tax Authorities.

## Issue of Employees Stock Option Scheme (ESOPs) / Sweat Equity

An Indian company may issue “employees’ stock option” and/or “sweat equity shares” to its employees/directors or employees/directors of its holding company or joint venture or wholly owned overseas subsidiary/subsidiaries who are resident outside India, provided that :

- a. The scheme has been drawn either in terms of regulations issued under the Securities Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014 notified by the Central Government under the Companies Act 2013, as the case may be.
- b. The “employee’s stock option”/ “sweat equity shares” issued to non-resident employees/directors under the applicable rules/regulations are in compliance with the sectoral cap applicable to the said company.
- c. Issue of “employee’s stock option”/ “sweat equity shares” by a company where foreign investment is under the approval route shall require prior approval of Government of India.
- d. Issue of “employee’s stock option”/ “sweat equity shares” under the applicable rules/regulations to an employee/director who is a citizen of Bangladesh/Pakistan shall require prior approval of the Government of India.
- e. The issuing company shall furnish to the Regional Office concerned of the Reserve Bank of India under whose jurisdiction the registered office of the company operates, within 30 days from the date of issue of employees’ stock option or sweat equity shares, a return as per the Form-ESOP.

## Share Swap

In cases of investment by way of swap of shares, irrespective of the amount, valuation of the shares will have to be made by a Merchant Banker registered with SEBI or an Investment Banker outside India registered with the appropriate regulatory authority in the host country. Approval of the Government will also be a prerequisite for investment by swap of shares for sector under Government approval route. No approval of the Government is required for investment in automatic route sectors by way of swap of shares.

## Pledge of Shares

The transfer of equity instruments of an Indian company or units of an investment vehicle by way of pledge is subject to the following terms and conditions, namely :-

- (i) any erosion being a promoter of a company registered in India (borrowing company), which has raised external commercial borrowing in compliance with the Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000 may pledge the shares of the borrowing company or that of its associate resident companies for the purpose of securing the external commercial borrowing raised by the borrowing company subject to the following further conditions, namely :-
  - (a) the period of such pledge shall be co-terminus with the maturity of the underlying external commercial borrowing;
  - (b) in case of invocation of pledge, transfer shall be made in accordance with these rules and directions issued by the Reserve Bank;
  - (c) the statutory auditor has certified that the borrowing company shall utilise or has utilised the proceeds of the external commercial borrowing for the permitted end-use only;
  - (d) no person shall pledge any such share unless a no-objection has been obtained from an authorised dealer bank that the above conditions have been complied with;

- (ii) any person resident outside India holding equity instruments in an Indian company or units of an investment vehicle may pledge the equity instruments or units, as the case may be,
  - (a) in favour of a bank in India to secure the credit facilities being extended to such Indian company for bona fide purposes,
  - (b) in favour of an overseas bank to secure the credit facilities being extended to such person or a person resident outside India who is the promoter of such Indian company or the overseas group company of such Indian company,
  - (c) in favour of a non-banking financial company registered with the Reserve Bank to secure the credit facilities being extended to such Indian company for bona fide purposes,
  - (d) subject to the authorised dealer bank satisfying itself of the compliance of the conditions stipulated by the Reserve Bank in this regard;
- (iii) in case of invocation of pledge, transfer of equity instruments of an Indian company or units shall be in accordance with entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions at the time of creation of pledge

## REMITTANCE, REPORTING AND VIOLATION

### Remittance of sale proceeds/Remittance on winding up/Liquidation of Companies:

- (i) Sale proceeds of shares and securities and their remittance is 'remittance of asset' governed by The Foreign Exchange Management (Remittance of Assets) Regulations, 2000 under FEMA.
- (ii) AD Category-I bank can allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India, provided the security has been held on repatriation basis, the sale of security has been made in accordance with the prescribed guidelines and NOC/tax clearance certificate from the Income Tax Department has been produced.

### Remittance on winding up/liquidation of Companies

AD Category-I banks have been allowed to remit winding up proceeds of companies in India, which are under liquidation, subject to payment of applicable taxes. Liquidation may be subject to any order issued by the court winding up the company or the official liquidator in case of voluntary winding up under the provisions of the Companies Act, as applicable. AD Category-I banks shall allow the remittance provided the applicant submits:

- (a) No objection or Tax clearance certificate from Income Tax Department for the remittance.
- (b) Auditor's certificate confirming that all liabilities in India have been either fully paid or adequately provided for.
- (c) Auditor's certificate to the effect that the winding up is in accordance with the provisions of the Companies Act, as applicable.
- (d) In case of winding up otherwise than by a court, an auditor's certificate to the effect that there are no legal proceeding spending in any court in India against the applicant or the company under liquidation and there is no legal impediment in permitting the remittance.

### Repatriation of Dividend

Dividends are freely repatriable without any restrictions (net after Tax deduction at source or Dividend Distribution Tax, if any, as the case may be). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

### Repatriation of Interest

Interest on fully, mandatorily & compulsorily convertible debentures is also freely repatriable without any restrictions (net of applicable taxes). The repatriation is governed by the provisions of the Foreign Exchange Management (Current Account Transactions) Rules, 2000, as amended from time to time.

## Reporting of FDI

The reporting requirements for any investment in India by a person resident in India under Foreign Exchange Management (Non-Debt Instruments) Rules, 2019 are specified by the RBI. Regulation 4 of the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 vide notification No. FEMA. 395/2019-RB dated 17.10.2019 issued by the RBI stipulates the reporting requirement for any investment in India by a person resident outside India.

All the reporting is required to be done through the Single Master Form (SMF) available on the Foreign Investment Reporting and Management System (FIRMS) platform at <https://firms.rbi.org.in>. The user manual for reporting is available at <https://firms.rbi.org.in/firms/faces/pages/login.xhtml>. The format of the SMF and KYC report is available in the user manual.

## Adherence to Guidelines/Orders and Consequences of Violation

FDI is a capital account transaction and thus any violation of FDI regulations are covered by the penal provisions of the FEMA. Reserve Bank of India administers the FEMA and Directorate of Enforcement under the Ministry of Finance is the authority for the enforcement of FEMA. The Directorate takes up investigation in any contravention of FEMA.

## Penalties

If a person violates/contravenes any FDI Regulations, by way of breach/non-adherence/non-compliance/contravention of any rule, regulation, notification, press note, press release, circular, direction or order issued in exercise of the powers under FEMA or contravenes any conditions subject to which an authorization is issued by the Government of India/ Reserve Bank of India, he shall, upon adjudication, be liable to a penalty up to thrice the sum involved in such contraventions where such amount is quantifiable, or up to two lakh Rupees where the amount is not quantifiable, and where such contraventions is a continuing one, further penalty which may extend to five thousand Rupees for every day after the first day during which the contraventions continues.

Where a person committing a contravention of any provisions of this Act or of any rule, direction or order made there under is a company (company means anybody corporate and includes a firm or other association of individuals as defined in the Companies Act), every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Any Adjudicating Authority adjudging any contraventions above, may, if he thinks fit in addition to any penalty which he may impose for such contravention direct that any currency, security or any other money or property in respect of which the contravention has taken place shall be confiscated to the Central Government.

## Adjudication and Appeals

For the purpose of adjudication of any contravention of FEMA, the Ministry of Finance as per the provisions contained in the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000 appoints officers of the Central Government as the Adjudicating Authorities for holding an enquiry in the manner prescribed. A reasonable opportunity has to be given to the person alleged to have committed contraventions against whom a complaint has been made for being heard before imposing any penalty.

The Central Government may appoint as per the provisions contained in the Foreign Exchange Management (Adjudication Proceedings and Appeal) Rules, 2000, an Appellate Authority/ Appellate Tribunal to hear appeals against the orders of the adjudicating authority.

## Compounding Proceedings

Under the Foreign Exchange (Compounding Proceedings) Rules 2000, the Central Government may appoint 'Compounding Authority' an officer either from Enforcement Directorate or Reserve Bank of India for any person contravening any provisions of the FEMA. The Compounding Authorities are authorized to compound the amount involved in the contravention to the Act made by the person. No contravention shall be compounded unless the

amount involved in such contravention is quantifiable. Any second or subsequent contravention committed after the expiry of a period of three years from the date on which the contravention was previously compounded shall be deemed to be a first contravention. The Compounding Authority may call for any information, record or any other documents relevant to the compounding proceedings. The Compounding

Authority shall pass an order of compounding after affording an opportunity of being heard to all the concerns as expeditiously and not later than 180 days from the date of application made to the Compounding Authority. Compounding Authority shall issue order specifying the provisions of the Act or of the rules, directions, requisitions or orders made there under in respect of which contravention has taken place along with details of the alleged contraventions.

### **PERMISSIBLE LIMITS UNDER PORTFOLIO INVESTMENT SCHEMES THROUGH STOCK EXCHANGES FOR /FPIs AND NRIs**

The permissible limits under portfolio investment schemes through stock exchanges for /FPIs and NRIs will be as follows:

- (i) The total holding by each FPI or an investor group, shall be less than 10 per cent of the total paid-up capital on a fully diluted basis or less than 10 per cent of the paid up value of each series of debentures or preference shares or share warrants, aggregate limit for all /FPIs cannot exceed 24 per cent of the total paid-up capital on a fully diluted basis or paid up value of each series of debentures or preference shares or share warrants.

With effect from the 1st April, 2020, the aggregate limit shall be the sectoral caps applicable to the Indian company as laid out in sub-paragraph (b) of paragraph 3 of Schedule I of these rules, with respect to its paid-up equity capital on a fully diluted basis or such same sectoral cap percentage of paid up value of each series of debentures or preference shares or share warrants. The aggregate limit as provided above may be decreased by the Indian company concerned to a lower threshold limit of 24% or 49% or 74% as deemed fit, with the approval of its Board of Directors and its General Body through a resolution and a special resolution, respectively before 31st March, 2020.

The Indian company which has decreased its aggregate limit to 24% or 49% or 74%, may increase such aggregate limit to 49% or 74% or the sectoral cap or statutory ceiling respectively as deemed fit, with the approval of its Board of Directors and its General Body through a resolution and a special resolution, respectively. Once the aggregate limit has been increased to a higher threshold, the Indian company cannot reduce the same to a lower threshold. However, the aggregate limit with respect to an Indian company in a sector where FDI is prohibited shall be 24 percent.

- (a) In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital on fully diluted basis or 5 percent of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company both on repatriation and non-repatriation basis and the total holdings of all NRIs and OCIs put together shall not exceed 10 per cent of the total paid-up capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.
- (b) Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority of India (IRDAI) in order to ensure that the 49 per cent limit of foreign shareholding applicable for the insurance sector is not being breached.
- (c) Transfer of shares under FDI from residents to non-residents shall require approval of RBI and/or Government wherever applicable.
- (d) The policies and procedures prescribed from time to time by RBI and other institutions such as SEBI, Ministry of Corporate Affairs and IRDAI on these matters will continue to apply.
- (e) RBI guidelines relating to acquisition by purchase or otherwise of shares of a private bank, if such acquisition results in any person owning or controlling 5 per cent or more of the paid-up capital of the private bank will apply to non-resident investors as well.

- (ii) Setting up of a subsidiary by foreign banks
  - (a) Foreign banks will be permitted to either have branches or subsidiaries but not both.
  - (b) Foreign banks regulated by banking supervisory authority in the home country and meeting Reserve Bank's licensing criteria will be allowed to hold 100 per cent paid up capital to enable them to set up a wholly-owned subsidiary in India.
  - (c) A foreign bank may operate in India through only one of the three channels viz., (i) branches (ii) a wholly-owned subsidiary and (iii) a subsidiary with aggregate foreign investment up to a maximum of 74 per cent in a private bank.
  - (d) A foreign bank will be permitted to establish a wholly-owned subsidiary either through conversion of existing branches into a subsidiary or through a fresh banking license. A foreign bank will be permitted to establish a subsidiary through acquisition of shares of an existing private sector bank provided at least 26 per cent of the paid capital of the private sector bank is held by residents at all times consistent with para (i) (b) above.
  - (e) A subsidiary of a foreign bank will be subject to the licensing requirements and conditions broadly consistent with those for new private sector banks.
  - (f) Guidelines for setting up a wholly-owned subsidiary of a foreign bank will be issued separately by RBI.
  - (g) All applications by a foreign bank for setting up a subsidiary or for conversion of their existing branches to subsidiary in India will have to be made to the RBI.
- (iii) At present there is a limit of ten per cent on voting rights in respect of banking companies, and this should be noted by potential investor. Any change in the ceiling can be brought about only after final policy decisions and appropriate Parliamentary approvals. All investments shall be subject to the guidelines prescribed for the banking sector under the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934.

### **ESTABLISHMENT OF BRANCH OFFICE (BO) / LIAISON OFFICE (LO) / PROJECT OFFICE (PO) IN INDIA**

Establishment of branch office/ liaison office / project office or any other place of business in India by foreign entities is regulated in terms of Section 6(6) of Foreign Exchange Management Act, 1999 read with Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016 and amended from time to time.

#### **Branch Office**

Branch office in relation to a company, means any establishment described as such by the company.

Permitted activities for a branch office in India of a person resident outside India

Normally, the branch office should be engaged in the activity in which the parent company is engaged.

- (i) Export/import of goods.
- (ii) Rendering professional or consultancy services.
- (iii) Carrying out research work in which the parent company is engaged.
- (iv) Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- (v) Representing the parent company in India and acting as buying/ selling agent in India.
- (vi) Rendering services in Information Technology and development of software in India.
- (vii) Rendering technical support to the products supplied by parent/group companies.
- (viii) Representing a foreign airline/shipping company.

#### **Liaison Office**

Liaison Office means a place of business to act as a channel of communication between the principal place of business or Head Office or by whatever name called and entities in India but which does not undertake any

commercial /trading/ industrial activity, directly or indirectly, and maintains itself out of inward remittances received from abroad through normal banking channel.

**Permitted activities for a liaison office in India of a person resident outside India**

- (i) Representing the parent company / group companies in India.
- (ii) Promoting export / import from / to India.
- (iii) Promoting technical/ financial collaborations between parent / group companies and companies in India.
- (iv) Acting as a communication channel between the parent company and Indian companies.

**Project Office**

Project office means a place of business in India to represent the interests of the foreign company executing a project in India but excludes a Liaison Office.

**Parameters of project office**

A foreign company may open project office/s in India provided it has secured from an Indian company, a contract to execute a project in India, and

- (i) the project is funded directly by inward remittance from abroad; or
- (ii) the project is funded by a bilateral or multilateral International Financing Agency; or
- (iii) the project has been cleared by an appropriate authority; or
- (iv) a company or entity in India awarding the contract has been granted term loan by a Public Financial Institution or a bank in India for the Project.

**General criteria**

i. Applications from foreign companies (a body corporate incorporated outside India, including a firm or other association of individuals) for establishing BO/ LO/ PO in India shall be considered by the AD Category-I bank as per the guidelines given by Reserve Bank of India (RBI). If the principal business of the entity resident outside India falls under sectors where 100 percent Foreign Direct Investment (FDI) is allowed in terms Foreign Exchange Management (Transfer or issue of Security by a Person Resident outside India) Regulations, 2000, as amended from time to time, and the entity seeks to open a BO/LO/PO, the AD Category-I bank may consider such applications under the delegated powers.

ii. An application from a person resident outside India for opening of a BO/LO/PO in India shall require prior approval of Reserve Bank of India in the following cases:

The applicant is a citizen of or is registered/incorporated in Pakistan

The applicant is a citizen of or is registered/incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands;

The principal business of the applicant falls in the four sectors namely Defence, Telecom, Private Security and Information and Broadcasting.\*

The applicant is a Non-Government Organisation (NGO), Non-Profit Organisation, Body/ Agency/ Department of a foreign government.\*\*

\* In the case of proposal for opening a PO relating to defence sector, no separate reference or approval of Government of India shall be required if the said non-resident applicant has been awarded a contract by/ entered into an agreement with Ministry of Defence or Service Headquarters or Defence Public Sector Undertakings. No separate approval is required from Reserve Bank of India for such cases only.

\*\* Such applications may be forwarded by the AD Category-I bank to the General Manager, Reserve Bank of India, Central Office Cell, Foreign Exchange Department, 6, Sansad Marg, New Delhi - 110 001 who shall process the applications in consultation with the Government of India.

iii. The non-resident entity applying for a BO/LO in India should have a financially sound track record viz:

|   |  |
|---|--|
| Branch Office   | A profit making track record during the immediately preceding five financial years in the home country and net worth of not less than USD 100,000 or its equivalent.<br><br><b>Net Worth</b> [total of paid-up capital and free reserves, less intangible assets as per the latest Audited Balance Sheet or Account Statement certified by a Certified Public Accountant or any Registered Accounts Practitioner by whatever name called]. |
| Liaison Office  | A profit making track record during the immediately preceding three financial years in the home country and net worth of not less than USD 50,000 or its equivalent.   |
| An applicant that is not financially sound and is a subsidiary of another company | May submit a Letter of Comfort (LOC) from its parent/ group company, subject to the condition that the parent/ group company satisfies the prescribed criteria for net worth and profit.   |

### Procedure for Establishment

i. The application for establishing BO / LO/ PO in India may be submitted by the non-resident entity in Form FNC to a designated AD Category - I bank (i.e. an AD Category – I bank identified by the applicant with whom they intend to pursue banking relations) along with the prescribed documents and the LOC, wherever applicable.

Following are the prescribed documents:

- (a) Copy of the Certificate of Incorporation / Registration; Memorandum of Association and Articles of Association attested by the Notary Public in the country of registration.  
[If the original Certificate is in a language other than in English, the same may be translated into English and notarized as above and cross verified/attested by the Indian Embassy/ Consulate in the home country].
- (b) Audited Balance sheet of the applicant company for the last three/ five years in case of branch office/ liaison office respectively.  
[If the applicants' home country laws/regulations do not insist on auditing of accounts, an Account Statement certified by a Certified Public Accountant (CPA) or any Registered Accounts Practitioner by any name, clearly showing the net worth may be submitted]
- (c) Bankers' Report from the applicant's banker in the host country / country of registration showing the number of years the applicant has had banking relations with that bank.
- (d) Power of Attorney in favour of signatory of Form FNC in case the Head of the overseas entity is not signing the Form FNC.

The AD Category-I bank shall after exercising due diligence in respect of the applicant's background, and satisfying itself as regards adherence to the eligibility criteria for establishing BO/LO/PO, antecedents of the promoter, nature and location of activity of the applicant, sources of funds, etc., and compliance with the extant KYC norms grant approval to the foreign entity for establishing BO/LO/PO in India.

- ii. However, before issuing the approval letter to the applicant, the AD Category-I bank shall forward a copy of the Form FNC along with the details of the approval proposed to be granted by it to the General Manager, Reserve Bank of India, CO Cell, New Delhi, for allotment of Unique Identification Number (UIN) to each BO/LO.

After receipt of the UIN from the Reserve Bank, the AD Category-I bank shall issue the approval letter to the non-resident entity for establishing BO/LO in India. This is in order to enable the Reserve Bank to keep, maintain and upload up-to-date list of all foreign entities which have been granted permission for establishing BO/LO in India, on its website.

- iii. The validity period of an LO is generally for three years, except in the case of Non-Banking Finance Companies (NBFCs) and those entities engaged in construction and development sectors, for whom the validity period is two years only.

The validity period of the project office is for the tenure of the project.

- iv. There is a general permission to non-resident companies to establish POs in India, provided they have secured a contract from an Indian company to execute a project in India. Also, the project must have secured the necessary regulatory clearances; and is funded directly by inward remittance from abroad; or the project is funded by a bilateral or multilateral International Financing Agency, or a company or entity in India awarding the contract has been granted Term Loan by a Public Financial Institution or a bank in India for the Project.

- v. An applicant that has received permission for setting up of a BO/LO/PO shall inform the designated AD Category I bank as to the date on which the BO/LO/PO has been set up. The AD Category I bank in turn shall inform Reserve Bank accordingly. In case an approval granted by the AD bank has either been surrendered by the applicant or has expired without any BO/LO/PO being set up, the AD Category I bank shall inform RBI accordingly.

- vi. The approval granted by the AD Category I bank should include a proviso to the effect that in case the BO/LO/PO for which approval has been granted is not opened within six months from the date of the approval letter, the approval shall lapse. In cases where the non-resident entity is not able to open the office within the stipulated time frame due to reasons beyond its control, the AD Category-I bank may consider granting extension of time for a further period of six months for setting up the office. Any further extension of time shall require the prior approval of Reserve Bank of India in this regard.

- vii. All applications for establishing a BO/LO in India by foreign banks and insurance companies will be directly received and examined by the Department of Banking Regulation (DBR), Reserve Bank of India, Central Office and the Insurance Regulatory and Development Authority (IRDA), respectively. No UIN for such representative offices is required from the Foreign Exchange Department, Reserve Bank of India.

- viii. There is a general permission to non-resident companies for establishing BO in the Special Economic Zones (SEZs) to undertake manufacturing and service activities subject to the conditions that:

- (a) such BOs are functioning in those sectors where 100% FDI is permitted;
- (b) such BOs comply with Chapter XXII of the Companies Act, 2013; and
- (c) such BOs function on a stand-alone basis.

### Opening of bank account by BO/LO/PO

- i. An LO may approach the designated AD Category I Bank in India to open an account to receive remittances from its Head Office outside India. It may be noted that an LO shall not maintain more than one bank account at any given time without the prior permission of Reserve Bank of India. The permitted Credits and Debits to the account shall be:

- (a) Credits

- 1. Funds received from Head Office through normal banking channels for meeting the expenses of the office.
- 2. Refund of security deposits paid from LO's account or directly by the Head Office through normal banking channels.

- 3. Refund of taxes, duties etc., received from tax authorities, paid from LO's bank account.
- 4. Sale proceeds of assets of the LO.
- b. Debits
  - Only for meeting the local expenses of the office.
- ii. A BO may approach any AD Category-I Bank in India to open an account for its operations in India. Credits to the account should represent the funds received from Head Office through normal banking channels for meeting the expenses of the office and any legitimate receivables arising in the process of its business operations. Debits to this account shall be for the expenses incurred by the BO and towards remittance of profits up proceeds.
- iii. Any foreign entity except an entity from Pakistan who has been awarded a contract for a project by the Government authority/Public Sector Undertakings or are permitted by the AD to operate in India may open a bank account without any prior approval of the Reserve Bank. An entity from Pakistan shall need prior approval of Reserve Bank of India to open a bank account for its project office in India.
- iv. AD Category - I banks can open non-interest bearing foreign currency account for POs in India subject to the following:
  - (a) The PO has been established in India, with the general / specific permission of Reserve Bank of India, having the requisite approval from the concerned Project Sanctioning Authority concerned as per FEM (Establishment in India of Branch Office or a Project Office or any other Place of Business Regulations, 2016).
  - (b) The contract governing the project specifically provides for payment in foreign currency.
  - (c) Each PO can open two foreign currency accounts, usually one denominated in USD and other in home currency of the project awardee, provided both are maintained with the same AD Category-I bank.
  - (d) The permissible debits to the account shall be payment of project related expenditure and credits shall be foreign currency receipts from the Project Sanctioning Authority and remittances from parent/group company abroad or bilateral / multilateral international financing agency.
  - (e) The responsibility of ensuring that only the approved debits and credits are allowed in the foreign currency account shall rest solely with the AD Category-I bank. Further, the accounts shall be subject to 100 per cent scrutiny by the Concurrent Auditor of the respective AD Category-I bank.
  - (f) The foreign currency accounts have to be closed at the completion of the project.

### Annual Activity Certificate by BO/LO/PO

- (i) The Annual Activity Certificate (AAC) as at the end of March 31 each year along with the required documents needs to be submitted by the following:
  - In case of a sole BO / LO/PO, by the BO/LO/PO concerned;
  - In case of multiple BOs / LOs, a combined AAC in respect of all the offices in India by the nodal office of the BOs / LOs.

The LO/BO needs to submit the AAC to the designated AD Category -I bank as well as Director General of Income Tax (International Taxation), New Delhi whereas the PO needs to submit the AAC only to the designated AD Category -I bank.
- (ii) The designated AD Category - I bank shall scrutinize the AACs and ensure that the activities undertaken by the BO/LO are being carried out in accordance with the terms and conditions of the approval given.

In the event of any adverse findings reported by the auditor or noticed by the designated AD Category -I bank, the same should immediately be reported to the General Manager, Reserve Bank of India, CO Cell, New Delhi, along with the copy of the AAC and their comments thereon.

## Extension of validity period of the approval of LO and PO

- i. Requests for extension of time for LOs may be submitted before the expiry of the validity of the approval, to the AD Category-I bank concerned under whose jurisdiction the LO/nodal office is located. The designated AD Category - I bank may extend the validity period of LO/s for a period of 3 years from the date of expiry of the original approval/ extension granted if the applicant has complied with the following conditions and the application is otherwise in order:
  - (a) The LO should have submitted the Annual Activity Certificates for the previous years and
  - (b) The account of the LO maintained with the designated AD Category - I bank is being operated in accordance with the terms and conditions stipulated in the approval letter.
 Such extension has to be granted, as expeditiously as possible as and in any case not later than one month from the receipt of the request under intimation to the General Manager, Reserve Bank of India, CO Cell, New Delhi quoting the reference number of the original approval letter and the UIN. Reserve Bank shall update the information on its website immediately.
- ii. Further, entities engaged in construction and development sectors and Non-Banking Finance Companies are permitted to open a liaison office for two years only. No further extension would be considered for liaison offices of entities which are Non-Banking Finance Companies and those engaged in construction and development sectors (excluding infrastructure development companies). Upon expiry of the validity period, the offices shall have to either close down or be converted into a Joint Venture / Wholly Owned Subsidiary in conformity with the extant Foreign Direct Investment policy.

## Registration with police authorities

Applicants from Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong, Macau or Pakistan desirous of opening BO/LO/PO in India shall have to register with the state police authorities. Copy of approval letter for 'persons' from these countries shall be marked by the AD Category-I bank to the Ministry of Home Affairs, Internal Security Division-I, Government of India, New Delhi for necessary action and record.

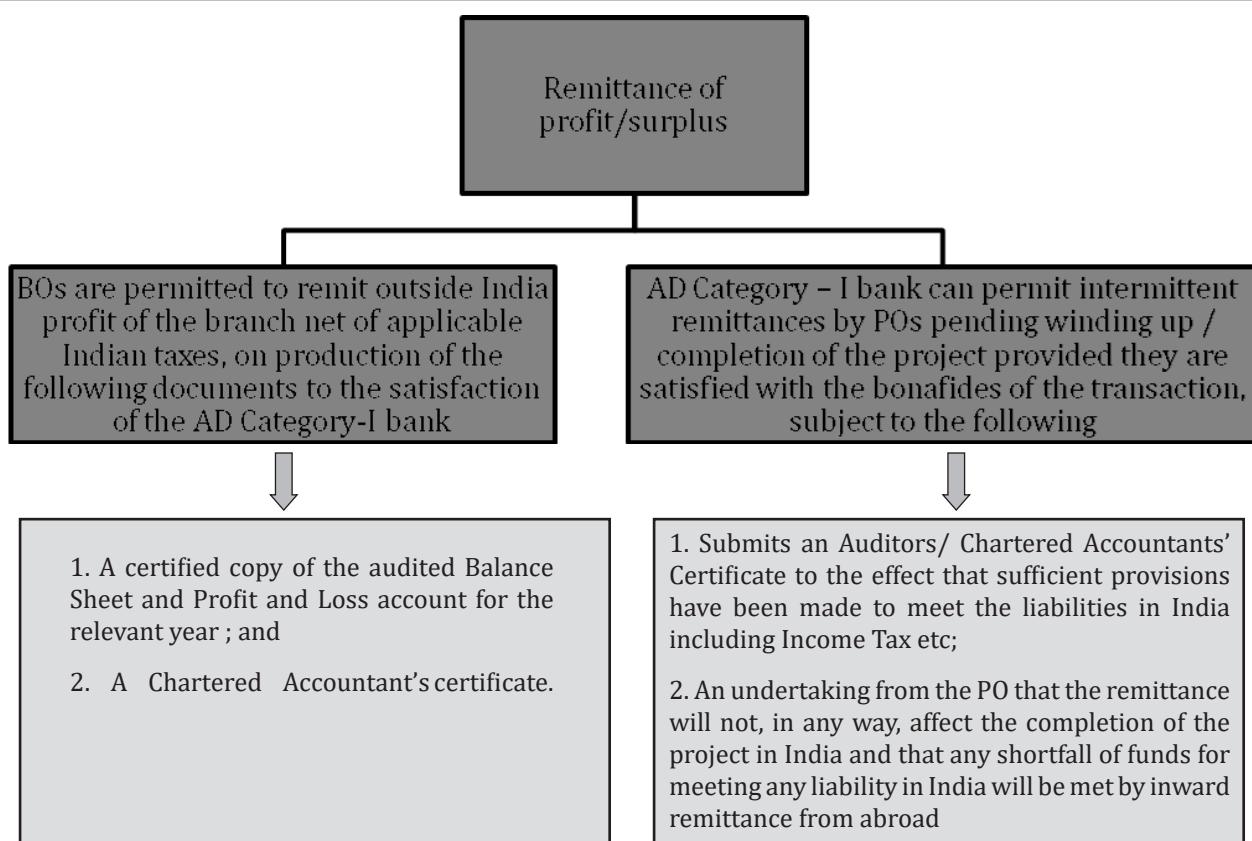
## Application for additional offices and activities

- i. Requests for establishing additional BOs / LOs may be submitted to the AD Category-I bank in a fresh FNC form. However, the documents mentioned in form FNC need not be resubmitted, if there are no changes to the documents already submitted earlier.
  - (a) If the number of offices exceeds 4 (i.e. one BO / LO in each zone viz; East, West, North and South), the applicant has to justify the need for additional office/s and it shall require prior approval of RBI.
  - (b) The applicant may identify one of its offices in India as the Nodal Office, which will coordinate the activities of all of its offices in India.
  - (c) Whenever the existing BO/LO is shifting to another city in India, prior approval from the AD Category-I bank is required. However, no permission is required if the LO/BO is shifted to another place in the same city subject to the condition that the new address is intimated to the designated AD Category-I bank. Changes in the postal address may be intimated to the CO Cell, New Delhi by the AD Category-I bank at the earliest.
- ii. Requests for undertaking activities in addition to what has been permitted initially (Annex C) by Reserve Bank of India/ AD Category-I bank may be submitted by the applicant to the Reserve Bank through the designated AD Category -I bank justifying the need.

## Extension of fund and non-fund based facilities

AD Category-I bank may be based on their business prudence, Board approved policy and compliance to extant rules/regulations stipulated by DBR, RBI extend fund/non-fund based facilities to BOs/POs only.

## Remittance of profit/surplus



- i. BOs are permitted to remit outside India profit of the branch net of applicable Indian taxes, on production of the following documents to the satisfaction of the AD Category-I bank through whom the remittance is effected:
  - (a) A certified copy of the audited Balance Sheet and Profit and Loss account for the relevant year.
  - (b) A Chartered Accountant's certificate certifying
    - (i) the manner of arriving at the remittable profit;
    - (ii) that the entire remittable profit has been earned by undertaking the permitted activities; and
    - (iii) that the profit does not include any profit on revaluation of the assets of the branch.
- ii. AD Category – I bank can permit intermittent remittances by POs pending winding up / completion of the project provided they are satisfied with the bonafides of the transaction, subject to the following:
  - (a) The PO submits an Auditors' / Chartered Accountants' Certificate to the effect that sufficient provisions have been made to meet the liabilities in India including Income Tax, etc.
  - (b) An undertaking from the PO that the remittance will not, in any way, affect the completion of the project in India and that any shortfall of funds for meeting any liability in India will be met by inward remittance from abroad.

**1.**

Requests for closure of the BO/LO/PO and submit the application along with following documents for remittance of winding up proceeds of BO/LO/PO to the designated AD Category- I bank

- Copy of the Reserve Bank's/AD Category- I bank's approval
- Auditor's certificate
- Confirmation from the applicant/parent company that no legal proceedings is pending in any court in India;
- A report from the Registrar of Companies regarding compliance with the provisions of the companies Act, 2013;
- The designated AD category- I bank has to ensure that the BO/LO/PO had filed their respective AACs; and
- Any other document/s, specified by reserve Bank of India / AD category-I bank.

**2.**

Designated AD category- I bank may allow remittance of winding up proceeds in respect of offices of bank and insurance companies, after obtaining copies of permission of closure from the sectoral regulators along with the documents mentioned above.

### **Closure of BO/LO/PO**

- i. Requests for closure of the BO / LO/ PO and allowing the remittance of winding up proceeds of BO / LO/ PO may be submitted to the designated AD Category - I bank by the BO / LO/ PO or their nodal office, as the case may be. The application for winding up may be submitted along with the following documents:
  - a. Copy of the Reserve Bank's/AD Category-I bank's approval for establishing the BO / LO / PO.
  - b. Auditor's certificate:
    - (i) indicating the manner in which the remittable amount has been arrived at and supported by a statement of assets and liabilities of the applicant and indicating the manner of disposal of assets;
    - (ii) confirming that all liabilities in India including arrears of gratuity and other benefits to employees, etc. of the office have been either fully met or adequately provided for; and
    - (iii) confirming that no income accruing from sources outside India (including proceeds of exports) has remained unrepatriated to India.
  - c. Confirmation from the applicant/parent company that no legal proceedings in any Court in India are pending against the BO / LO/ PO and there is no legal impediment to the remittance.
  - d. A report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 2013, in case of winding up of the BO /LO in India, wherever applicable.
  - e. The designated AD Category - I banks has to ensure that the BO / LO/ PO had filed their respective AACs.
  - f. Any other document/s, specified by Reserve Bank of India/AD Category-I bank while granting approval.
- ii. Designated AD Category-I bank may allow remittance of winding up proceeds in respect of offices of banks and insurance companies, after obtaining copies of permission of closure from the sectoral regulators along with the documents mentioned above.

## Transfer of assets of BO/LO/PO

Proposals for transfer of assets may be considered by the AD Category-I bank only from BOs/LOs/POs who are adhering to the operational guidelines such as submission of AACs (up to the current financial year) at regular annual intervals with copies endorsed to DGIT (International Taxation); have obtained PAN from IT Authorities and have got registered with ROC under the Companies Act 2013, if necessary. Also,

- (i) Transfer of assets by way of sale to the JV/WoS be allowed by AD Category-I bank only when the non-resident entity intends to close their BO/LO/PO operations in India.
- (ii) A certificate is to be submitted from the Statutory Auditor furnishing details of assets to be transferred indicating their date of acquisition, original price, depreciation till date, present book value or written down value (WDV) and sale consideration to be obtained. Statutory Auditor should also confirm that the assets were not re-valued after their initial acquisition. The sale consideration should not be more than the book value in each case.
- (iii) The assets should have been acquired by the BO/LO/PO from inward remittances and no intangible assets such as good will, pre-operative expenses should be included. No revenue expenses such as lease hold improvements incurred by the BO/LO can be capitalised and transferred to JV/WoS.
- (iv) AD Category-I bank must ensure payment of all applicable taxes while permitting transfer of assets.
- (v) Credits to the bank accounts of BO/LO/PO on account of such transfer of assets will be treated as permissible credits.
- (vi) Donation by BO/LO/PO of old furniture, vehicles, computers and other office items etc. to NGOs or other not-for-profit organisations may be permitted by the AD category-I banks after satisfying itself about the bonafide of the transaction.

## Checklist for BO/LO/PO

|   |  |  |
|---|--|--|
| 1 | Register with the Registrar of Companies (ROC)                 | A BO/LO/PO or any other place of business by whatever name called is required to register with the Registrar of Companies (ROCs) once it establishes a place of business in India if such registration is required under the Companies Act, 2013.                    |
| 2 | Application to an Authorised Dealer Category-I bank (Form FNC) | A person resident outside India desiring to establish a branch office or a liaison office or a project office or any other place of business in India shall submit an application in Form FNC to an Authorised Dealer Category-I bank.                               |
| 3 | Profit Making Track Record                                     | A branch office or a liaison office or a project office need to meet the profit making track record.   |
| 4 | Permissible Activities   | A branch office or a liaison office or a project office shall undertake or carry on permissible activities and shall not undertake or carry on any other activity unless otherwise specifically permitted by the Reserve Bank.                                       |
| 5 | Obtain Permanent Account Number (PAN)                          | The BOs / LOs shall obtain Permanent Account Number (PAN) from the Income Tax Authorities on setting up of their office in India and report the same in the AACs.  |
| 6 | LO upgrade into a BO   | The existing PAN and bank accounts can be continued when an LO is permitted to upgrade into a BO.  |
| 7 | Transaction  | Each BO/ LO/PO are required to transact through one designated AD Category-I bank only who shall be responsible for the due diligence and KYC norms of the BO/LO/PO. BO /LO/PO, present in multiple locations, are required to transact through their designated AD. |
| 8 | Annual Activity Certificate(AAC)                               | The branch office/liaison office shall submit the Annual Activity Certificate as at the end of March 31 along with the audited financial statements including receipt and payment account on or before September 30 of that year.                                    |

|    |   |  |
|----|---|--|
| 9  | BO/LO/PO change their existing AD Category-I bank                             | BO/LO/PO can change their existing AD Category-I bank subject to both the AD banks giving consent in writing for the transfer and the transferring AD bank confirming submission of all AACs and absence of any adverse features in conducting the account by the BO/LO/PO.  |
| 10 | Acquisition of property by BO/PO  | Acquisition of property by BO/PO shall be governed by the guidelines issued under Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations.  |
| 11 | Carry out permitted/ incidental activities from leased property               | As per section 6 (3) (h) of the Foreign Exchange Management Act, 1999, BOs/ LOs/POs have general permission to carry out permitted/ incidental activities from leased property subject to lease period not exceeding five years.   |
| 12 | Term Deposit Account  | AD Category-I bank can allow term deposit account for a period not exceeding 6 months in favour of a BO/LO/PO of a person resident outside India provided the bank is satisfied that the term deposit is out of temporary surplus funds and the BO/LO/PO furnishes an undertaking that the maturity proceeds of the term deposit will be utilised for their business in India within 3 months of maturity. However, such facility may not be extended to shipping/ airline companies.  |
| 13 | The foreign entities who may have established LO or BO in the pre-FEMA period | In case a BO/LO has been established and continues to exist without approval of the Reserve Bank, such BO/LO may approach their AD Category-I bank to regularise their offices under FEMA 1999, even if permission of Reserve Bank was not required as per the regulations existing at the time of setting up of the office. Such cases may be brought to the notice of Reserve Bank immediately for allotment of UIN. The foreign entities who may have established LO or BO with the permission from the Government of India in the pre-FEMA period shall also approach their AD Category-I bank with a copy of the said approval for allotment of a UIN by the Reserve Bank.  |
| 14 | Change in the name of the existing LO/BO                                      | Change in the name of the existing LO/BO may be permitted by the AD Category-I bank only if the non-resident entity changes its name without change in ownership and if the application to this effect is received with the Board resolution for change of name and documents/certificate from ROC India showing change of name. The change in name of the BO/LO should be reported to FED, CO Cell, New Delhi. Where change in name is requested on account of acquisitions or mergers of foreign entities involving change in ownership, the acquired entity or new entity is required to apply afresh by closing the existing entity. Foreign entities should note that the approvals are given by the Reserve Bank/AD Category-I bank after detailed scrutiny as per laid down guidelines and FDI policies and hence the approvals given to one foreign entity is not transferrable to another foreign entity. |
| 15 | Change in the Top Management  | Change in the Top Management or CEO/MD/CMD etc. of the BO/LO does not require prior approval from the Reserve Bank/AD Category-I bank. However, AD Category-I bank should be intimated about the same.   |
| 16 | Closure of the Branch office/Liaison office                                   | Requests for closure of the branch office/liaison office may be submitted to the Authorised Dealer Category - I bank along with the copy of the Reserve Bank's/ Authorised Dealer Category-I bank's approval for establishing the office; Auditor's certificate; Confirmation from the applicant/parent company that no legal proceedings in any Court in India are pending against the office and there is no legal impediment to the remittance; A report from the Registrar of Companies regarding compliance with the provisions of the Companies Act, 2013, in case of winding up of the branch office/liaison in India and any other document/s specified by the Reserve Bank/Authorised Dealer Category-I bank while granting approval.   |
| 17 | Remittance of winding up proceeds   | Remittance of winding up proceeds of branch or liaison office established in India shall be governed by the guidelines issued under Foreign Exchange Management (Remittance of Assets) Regulations   |

## ESTABLISHMENT OF BRANCH OFFICE (BO) / LIAISON OFFICE (LO) / PROJECT OFFICE (PO) OR ANY OTHER PLACE OF BUSINESS IN INDIA BY FOREIGN LAW FIRMS

Reserve Bank of India vide its RBI/2020-21/69 A.P. (DIR Series) Circular No. 07 dated November 23, 2020 advised all Category - I Authorized Dealer Banks that:

The Hon'ble Supreme Court has while disposing of the case, held that advocates enrolled under the Advocates Act, 1961 alone are entitled to practice law in India and that foreign law firms/companies or foreign lawyers cannot practice profession of law in India. As such, foreign law firms/companies or foreign lawyers or any other person resident outside India, are not permitted to establish any branch office, project office, liaison office or other place of business in India for the purpose of practicing legal profession. Accordingly, AD Category - I banks are directed not to grant any approval to any branch office, project office, liaison office or other place of business in India under FEMA for the purpose of practicing legal profession in India. Further, they shall bring to the notice of the Reserve Bank in case any such violation of the provisions of the Advocates Act comes to their notice.

## FOREIGN EXCHANGE MANAGEMENT (NON-DEBT INSTRUMENTS) RULES, 2019

### Introduction

In exercise of the powers conferred under Section 46(2) (aa) and (ab) of the Foreign Exchange Management Act, 1999 and in supersession of the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017 and the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2018, the Central Government issued Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

### Important Definitions

**“Asset Reconstruction Company”** means a company registered with the Reserve Bank under section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

**‘Convertible Note’** means an instrument issued by a startup company acknowledging receipt of money initially as debt, repayable at the option of the holder, or which is convertible into such number of equity shares of that company, within a period not exceeding five years from the date of issue of the convertible note, upon occurrence of specified events as per other terms and conditions agreed and indicated in the instrument.

**“Depository Receipt”** means a foreign currency denominated instrument, whether listed on an international exchange or not, issued by a foreign depository in a permissible jurisdiction on the back of eligible securities issued or transferred to that foreign depository and deposited with a domestic custodian and includes ‘global depository receipt’ as defined in the Companies Act, 2013.

**“Domestic Custodian”** means a custodian of securities registered with the Securities and Exchange Board of India in accordance with the SEBI (Custodian of Securities) Regulations, 1996.

**“Domestic Depository”** means a custodian of securities registered with the Securities and Exchange Board of India and authorised by the issuing entity to issue Indian depository receipts.

**“ESOP”** means ‘Employees’ stock option’ as defined under the Companies Act, 2013 and issued under the regulations by the Securities and Exchange Board of India.

**“Equity Instruments”** means equity shares, convertible debentures, preference shares and share warrants issued by an Indian company;

Explanation:-

- (i) Equity shares issued in accordance with the provisions of the Companies Act, 2013 shall include equity shares that have been partly paid. “Convertible debentures” means fully, compulsorily and mandatorily convertible debentures. “Preference shares” means fully, compulsorily and mandatorily convertible preference shares. Share Warrants are those issued by an Indian company in accordance with the regulations by the Securities

and Exchange Board of India. Equity instruments can contain an optionality clause subject to a minimum lock-in period of one year or as prescribed for the specific sector, whichever is higher, but without any option or right to exit at an assured price.

- (ii) Partly paid shares that have been issued to a person resident outside India shall be fully called-up within twelve months of such issue or as may be specified by the Reserve Bank from time to time. Twenty-five per cent of the total consideration amount (including share premium, if any) shall be received upfront.
- (iii) In case of share warrants, at least twenty-five per cent of the consideration shall be received upfront and the balance amount within eighteen months of the issuance of share warrants.

**“Escrow Account”** means an escrow account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

**“FVCI”** means a Foreign Venture Capital Investor incorporated and established outside India and registered with the Securities and Exchange Board of India under the Securities and Exchange Board of India (Foreign Venture Capital Investors) Regulations, 2000.

**“Foreign Central Bank”** means an institution or organisation or body corporate established in a country outside India and entrusted with the responsibility of carrying out central bank functions under the law for the time being in force in that country.

**“FCNR (B) account”** means a Foreign Currency Non-Resident (Bank) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016;

**“FCCB” or “Foreign Currency Convertible Bond”** means a bond issued under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993.

**“FDI” or “Foreign Direct Investment”** means investment through equity instruments by a person resident outside India in an unlisted Indian company; or in ten per cent or more of the post issue paid-up equity capital on a fully diluted basis of a listed Indian company.

Note:- In case an existing investment by a person resident outside India in equity instruments of a listed Indian company falls to a level below ten percent, of the post issue paid-up equity capital on a fully diluted basis, the investment shall continue to be treated as FDI;

Explanation: - Fully diluted basis means the total number of shares that would be outstanding if all possible sources of conversion are exercised.

**“Foreign Investment”** means any investment made by a person resident outside India on a repatriable basis in equity instruments of an Indian company or to the capital of a LLP.

Explanation: - If a declaration is made by a person as per the provisions of the Companies Act, 2013 about a beneficial interest being held by a person resident outside India, then even though the investment may be made by a resident Indian citizen, the same shall be counted as foreign investment;

Note:- A person resident outside India may hold foreign investment either as FDI or as FPI in any particular Indian company.

**“Foreign Portfolio Investment”** means any investment made by a person resident outside India through equity instruments where such investment is less than ten percent of the post issue paid-up share capital on a fully diluted basis of a listed Indian company or less than ten percent of the paid-up value of each series of equity instrument of a listed Indian company.

**“FPI” or “Foreign Portfolio Investor”** means a person registered in accordance with the provisions of the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014.

**“Government approval”** means the approval from the erstwhile Secretariat for Industrial Assistance (SIA), Department of Industrial Policy and Promotion, Government of India and/ or the erstwhile Foreign Investment Promotion Board (FIPB) and/ or any of the ministry/ department of the Government of India, as the case may be.

**“Group Company”** means two or more enterprises which, directly or indirectly, are in a position to (i) exercise twenty-six per cent, or more of voting rights in other enterprise; or (ii) appoint more than fifty per cent of members of Board of Directors in the other enterprise.

**“Hybrid Securities”** means hybrid instruments such as optionally or partially convertible preference shares or debentures and other such instruments as specified by the Central Government from time to time, which can be issued by an Indian company or trust to a person resident outside India.

**“Indian company”** means a company incorporated in India.

**“IDR” or “Indian Depository Receipts (IDRs)”** means any instrument in the form of a depository receipt created by a domestic depository in India and authorised by a company incorporated outside India making an issue of such depository receipts.

**“Indian entity”** shall mean an Indian company or a LLP.

**“Investing Company”** means an Indian company holding only investments in other Indian company/ies directly or indirectly, other than for trading of such holdings or securities.

**“Investment”** means to subscribe, acquire, hold or transfer any security or unit issued by a person resident in India.

Explanation:-

- (i) Investment shall include to acquire, hold or transfer depository receipts issued outside India, the underlying of which is a security issued by a person resident in India;
- (ii) for the purpose of LLP, investment shall mean capital contribution or acquisition or transfer of profit shares.

**“Investment on Repatriation Basis”** means an investment, sale or maturity proceeds of which are net of taxes, eligible to be repatriated out of India, and the expression “investment on non-repatriation basis”, shall be construed accordingly;

**“Investment Vehicle”** means an entity registered and regulated under the regulations framed by the Securities and Exchange Board of India or any other authority designated for that purpose and shall include, namely:-

- (i) Real Estate Investment Trusts (REITs) governed by the Securities and Exchange Board of India (REITs) Regulations, 2014; (ii) Infrastructure Investment Trusts (InvITs) governed by the Securities and Exchange Board of India (InvITs) Regulations, 2014 (iii) Alternative Investment Funds (AIFs) governed by the Securities and Exchange Board of India (AIFs) Regulations, 2012.

**“Listed Indian Company”** means an Indian company which has any of its equity instruments or debt instruments listed on a recognised stock exchange in India and the expression “unlisted Indian company” shall be construed accordingly.

**“Manufacture”**, with its grammatical variations, means a change in a non-living physical object or article or thing,:- (i) resulting in transformation of the object or article or thing into a new and distinct object or article or thing having a different name, character and use; or (ii) bringing into existence of a new and distinct object or article or thing with a different chemical composition or integral structure.

**“Non-Debt Instruments”** means the following instruments; namely:-

- (i) all investments in equity instruments in incorporated entities: public, private, listed and unlisted;
- (ii) capital participation in LLP;
- (iii) all instruments of investment recognised in the FDI policy notified from time to time;
- (iv) investment in units of Alternative Investment Funds (AIFs), Real Estate Investment Trust (REITs) and Infrastructure Investment Trusts (InvITs);
- (v) investment in units of mutual funds or Exchange-Traded Fund (ETFs) which invest more than fifty per cent in equity;

- (vi) junior-most layer (i.e. equity tranche) of securitisation structure;
- (vii) acquisition, sale or dealing directly in immovable property;
- (viii) contribution to trusts; and
- (ix) depository receipts issued against equity instruments.

**“NRI” or “Non-Resident Indian”** means an individual resident outside India who is a citizen of India.

**“OCI” or “Overseas Citizen of India”** means an individual resident outside India who is registered as an Overseas Citizen of India Cardholder under section 7A of the Citizenship Act, 1955.

**“Resident Indian Citizen”** means an individual who is a person resident in India and is a citizen of India by virtue of the Constitution of India or the Citizenship Act, 1955.

**“Sectoral Cap”** means the maximum investment including both foreign investment on a repatriation basis by persons resident outside India in equity instruments of a company or the capital of a LLP, as the case may be, and indirect foreign investment, unless provided otherwise. This shall be the composite limit for the Indian investee entity.

Explanation:

- (i) FCCBs and DRs having underlying of instruments being in the nature of debt shall not be included in the sectoral cap;
- (ii) any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned under the sectoral cap;

**“Start-up Company”** means a private company incorporated under the Companies Act, 2013 and identified under G.S.R. 180(E), dated the 17th February, 2016 issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry;

**“Venture Capital Fund”** means a fund established in the form of a trust, a company including a body corporate and registered under the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012.

## GENERAL CONDITIONS APPLICABLE TO ALL INVESTORS

### Restriction on investment in India by a person resident outside India

Rule 3 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that save as otherwise provided in the Foreign Exchange Management Act, 1999 or rules or regulations made thereunder, no person resident outside India shall make any investment in India:

An investment made in accordance with the Foreign Exchange Management Act, 1999 or the rules or the regulations made thereunder and held on the date of commencement of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 shall be deemed to have been made under Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and shall accordingly be governed by Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

Reserve Bank of India may, on an application made to it and for sufficient reasons and in consultation with the Central Government, permit a person resident outside India to make any investment in India subject to such conditions as may be considered necessary.

### Restriction on receiving investment

Rule 4 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that save as otherwise provided in the Foreign Exchange Management Act, 1999 or rules or regulations made thereunder, an Indian entity or an investment vehicle, or a venture capital fund or a firm or an association of persons or a proprietary concern shall not receive any investment in India from a person resident outside India or record such investment in its books:

Reserve Bank of India may, on an application made to it and for sufficient reasons and in consultation with the Central Government, permit an Indian entity or an investment vehicle, or a venture capital fund or a firm or an

association of persons or a proprietary concern to receive any investment in India from a person resident outside India or to record such investment subject to such conditions as may be considered necessary.

### Permission for making investment by a person resident outside India

According to Rule 5 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, unless otherwise specified in Foreign Exchange Management (Non-debt Instruments) Rules, 2019 or the Schedules, any investment made by a person resident outside India shall be subject to the entry routes, sectoral caps or the investment limits, as the case may be, and the attendant conditionalities for such investment as laid down in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

### Investments by person resident outside India

According to Rule 6(a) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India may subscribe, purchase or sell equity instruments of an Indian company in the manner and subject to the specified terms and conditions.

Provided that an entity of a country, which shares land border with India or the beneficial owner of an investment into India who is situated in or is a citizen of any such country, shall invest only with the Government approval:

Provided further that, a citizen of Pakistan or an entity incorporated in Pakistan shall invest only under the Government route, in sectors or activities other than defence, space, atomic energy and such other sectors or activities prohibited for foreign investment:

Provided also that in the event of the transfer of ownership of any existing or future FDI in an entity in India, directly or indirectly, resulting in the beneficial ownership falling within the restriction or purview of the above provisos, such subsequent change in beneficial ownership shall also require government approval.

It may be noted that issue or transfer of "participating interest or right" in oil fields by Indian companies to a person resident outside India would be treated as foreign investment and shall comply with the specified conditions.

### Purchase or sale of equity instruments of an Indian company by a person resident outside India as provided in Schedule I of the Rules

An Indian company may issue equity instruments to a person resident outside India subject to entry routes, sectoral caps and attendant conditionalities as prescribed in the Schedule of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

A person resident outside India may purchase equity instruments of a listed Indian company on a stock exchange in India. Provided that -

- (i) the person resident outside India making the investment has already acquired control of such company in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 and continues to hold such control;
- (ii) the amount of consideration may be paid as per the mode of payment specified by the Reserve Bank or out of the dividend payable by Indian investee company in which the person resident outside India has acquired and continues to hold the control in accordance with SEBI (Substantial Acquisition of Shares and Takeover) Regulations, 2011 provided the right to receive dividend is established and the dividend amount has been credited to a specially designated noninterest bearing rupee account for acquisition of shares on the recognised stock exchange.

A wholly owned subsidiary set up in India by a non-resident entity, operating in a sector where 100 percent foreign investment is allowed in the automatic route and there are no FDI linked performance conditions, may issue equity instruments to the said non-resident entity against pre- incorporation or pre-operative expenses incurred by the said non-resident entity up to a limit of five percent of its authorised capital or USD 500,000 whichever is less, subject to the condition that within thirty days from the date of issue of equity instruments but not later than one year from the date of incorporation or such time as the Reserve Bank permits, the Indian company shall report the transaction to the Reserve Bank as per the reporting requirements as specified by the Reserve Bank.

An Indian company may issue, subject to compliance with the conditions prescribed by the Central Government and/or the Reserve Bank from time to time, equity instruments to a person resident outside India, if the Indian investee company is engaged in an automatic route sector, against,-

- (i) swap of equity instruments; or
- (ii) import of capital goods or machinery or equipment (excluding second-hand machinery); or
- (iii) pre-operative or pre-incorporation expenses (including payments of rent etc.) :

Provided that the Government approval shall be obtained if the Indian investee company is engaged in a sector under Government route and the applications for approval shall be made in the manner prescribed by the Central Government from time to time.

An Indian company may issue equity shares against any funds payable by it to a person resident outside India, the remittance of which is permitted under the Act or the rules and regulations framed or directions issued thereunder or does not require prior permission of the Central Government or the Reserve Bank under the Act or the rules and regulations framed or directions issued thereunder or has been permitted by the Reserve Bank under the Act or the rules and regulations framed or directions issued thereunder:

Provided that in case where permission has been granted by the Reserve Bank for making remittance, the Indian company may issue equity shares against such remittance provided all regulatory actions with respect to the delay or contravention under the Act or the rules or the regulations framed thereunder have been completed.

The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

### **Sectors prohibited for FDI.-**

1. Lottery business including Government or private lottery, online lotteries, etc.
2. Gambling and betting including casinos, etc.
3. Chit funds
4. Nidhi company
5. Trading in Transferable Development Rights
6. Real estate business or construction of farm houses

Explanation: For the purpose of this rule, 'real estate business shall not include development of townships, construction of residential or commercial premises, roads or bridges and Real Estate Investment Trusts (REITs) registered and regulated under the SEBI (REITs) Regulations, 2014.

7. Manufacturing of cigars, cheroots, cigarillos and cigarettes, of tobacco or of tobacco substitutes.
8. Activities or sectors not open to private sector investment e.g. (I) Atomic energy and (II) Railway operations (other than permitted activities)
9. Foreign technology collaborations in any form including licensing for franchise, trademark, brand name, management contract is also prohibited for lottery business and gambling and betting activities.

### **Permitted sectors, entry routes and sectoral caps for total foreign investment**

Unless otherwise specified in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 or the Schedules, the entry routes and sectoral caps for the total foreign investment in an Indian entity shall be as follows, namely :-

#### **(a) Entry routes**

- (i) "Automatic route" means the entry route through which investment by a person resident outside India does not require the prior approval of the Reserve Bank or the Central Government;
- (ii) "government route" means the entry route through which investment by a person resident outside India requires prior Government approval and foreign investment received under this route shall be in accordance with the conditions stipulated by the Government in its approval.

- (iii) Aggregate foreign portfolio investment up to forty-nine percent of the paid-up capital on a fully diluted basis or the sectoral or statutory cap, whichever is lower, shall not require Government approval or compliance of sectoral conditions as the case may be, if such investment does not result in transfer of ownership and control of the resident Indian company from resident Indian citizens or transfer of ownership or control to persons resident outside India and other investments by a person resident outside India shall be subject to the conditions of Government approval and compliance of sectoral conditions as laid down in these rules.

**(b) Sectoral caps**

- (i) Sectoral cap for the sectors or activities specified in the table is the limit indicated against each sector. The total foreign investment shall not exceed the sectoral or statutory cap.
- (ii) Foreign investment in the following sectors or activities is subject to applicable laws or regulations, security and other conditionalities.
- (iii) In sectors or activities not listed below or not prohibited under Foreign Exchange Management (Non- debt Instruments) Rules, 2019, foreign investment is permitted up to one hundred percent on the automatic route, subject to applicable laws or regulations, security and other conditionalities.
- (iv) Wherever there is a requirement of minimum capitalisation, it shall include premium received along with the face value of the equity instrument, only when it is received by the company upon issue of such instruments to the person resident outside India and the amount paid by the transferee during post- issue transfer beyond the issue price of the capital instrument, shall not be taken into account while calculating minimum capitalization requirement.
- (v) (A) Foreign Investment in investing companies not registered as Non-Banking Financial Companies with the Reserve Bank and in core investment companies (CICs), both engaged in the activity of investing in the capital of other Indian entities, shall require prior approval of the Government.  
Note: Compliance to these rules by the core investment companies is in addition to the compliance of the regulatory framework prescribed to such companies as NBFCs under the Reserve Bank of India Act, 1934 and regulations framed thereunder.
- (B) Foreign investment in investing companies registered as Non-Banking Financial Companies (NBFCs) with the Reserve Bank, shall be under 100% automatic route.
- (vi) For undertaking activities which are under automatic route and without FDI linked performance conditions, an Indian company which does not have any operations and also has not made any downstream investment that is treated as indirect foreign investment for the investee entity, may receive investment in its equity instruments from persons resident outside India under automatic route, however, approval of the Government shall be required for such companies for undertaking activities which are under Government route and as and when such a company commences business or makes downstream investment that is treated as indirect foreign investment for the investee entity, it shall have to comply with the relevant sectoral conditions on entry route, conditionalities and caps.
- (vii) The onus of compliance with the sectoral or statutory caps on such foreign investment and attendant conditions, if any, shall be on the company receiving foreign investment.
- (viii) Wherever the person resident outside India who has made foreign investment specifies a particular auditor or audit firm having international network for the audit of the Indian investee company, then audit of such investee company shall be carried out as joint audit wherein one of the auditors is not part of the same network.

**PERMITTED SECTOR**

| Sl. No | Sector/ Activity   | Sectoral Cap | Entry Route |
|--------|--|--------------|-------------|
| 1.     | Agriculture and Animal Husbandry<br>(a) Floriculture, Horticulture and Cultivation of vegetables and mushrooms under controlled conditions;<br>(b) Development and production of seeds and planting material;<br>(c) Animal Husbandry (including breeding of dogs), Pisciculture,<br>(d) Aquaculture and Apiculture; and<br>(e) Services related to agro and allied sectors.<br>Note: Other than the above, foreign investment is not allowed in any other agricultural sector or activity.  | 100%         | Automatic   |
| 2.     | Plantation<br>(a) Tea sector including tea plantations<br>(b) Coffee plantations<br>(c) Rubber plantations<br>(d) Cardamom plantations<br>(e) Palm oil tree plantations<br>(f) Olive oil tree plantation<br>Note: Foreign investment is not allowed in any plantation sector/ activity other than those listed above.  | 100%         | Automatic   |
| 3      | Mining and Exploration of metal and non-metal ores including diamond, gold, silver and precious ores but excluding titanium bearing minerals and its ores; subject to the Mines and Minerals (Development and Regulation) Act, 1957.   | 100%         | Automatic   |
| 4      | Coal and Lignite mining for captive consumption by power projects, iron and steel and cement units and other eligible activities permitted under and subject to the provisions of Coal Mines (Nationalization) Act, 1973.<br>Setting up coal processing plants like washeries, subject to the condition that the company shall not do coal mining and shall not sell washed coal or sized coal from its coal processing plants in the open market and shall supply the washed or sized coal to those parties who are supplying raw coal to coal processing plants for washing or sizing. | 100%         | Automatic   |
| 5      | Mining and mineral separation of titanium bearing minerals and ores, its value addition and integrated activities subject to sectoral regulations and the Mines and Minerals (Development and Regulation) Act, 1957.   | 100%         | Government  |
| 6      | Exploration activities of oil and natural gas fields, infrastructure related to marketing of petroleum products and natural gas, marketing of natural gas and petroleum products, petroleum product pipelines, natural gas/ pipelines, LNG Regasification infrastructure, market study and formulation and Petroleum refining in the private sector; subject to the existing sectoral policy and regulatory framework in the oil marketing sector and the policy of the Government on private participation in exploration of oil and the discovered fields of national oil companies.   | 100%         | Automatic   |

|    |  |      |  |
|----|--|------|--|
| 7  | Petroleum refining by the Public Sector Undertakings (PSUs), without any disinvestment or dilution of domestic equity in the existing PSUs.  | 49%  | Automatic  |
| 8. | Manufacturing  | 100% | Automatic  |
| 9  | Defence Industry subject to Industrial license under the Industries (Development & Regulation) Act, 1951; and<br><br>Manufacturing of small arms and ammunition under the Arms Act, 1959   | 100% | Automatic route up to 74% Government route beyond 74% wherever it is likely to result in access to modern technology or for other reasons to be recorded.<br><br>* will take effect from the date of FEMA (Foreign Exchange Management Act) notification |
| 10 | Broadcasting Carriage Services<br><br>(a) Teleports (setting up of up-linking HUBs/ Teleports);<br>(b) Direct to Home (DTH);<br>(c) Cable Networks (Multi System Operators (MSOs) operating at National or State or District level and undertaking up-gradation of networks towards digitalization and addressability);<br>(d) Mobile TV;<br>(e) Head-end-in-the Sky Broadcasting Service (HITS) | 100% | Automatic  |
| 11 | Broadcasting Carriage Services<br><br>Cable Networks (Other MSOs not undertaking up-gradation of networks towards digitalization and addressability and Local Cable Operators (LCOs)).   | 100% | Automatic  |
| 12 | Broadcasting Content Services<br><br>Terrestrial Broadcasting FM (FM Radio), subject to such terms and conditions, as specified from time to time, by Ministry of Information and Broadcasting, for grant of permission for setting up of FM Radio stations.   | 49%  | Government   |
| 13 | Broadcasting Content Services<br><br>Up-Linking of 'News & Current Affairs' TV Channels  | 49%  | Government   |
| 14 | Broadcasting Content Services<br><br>Up-linking of Non-'News & Current Affairs' TV Channels/ Downlinking of TV Channels  | 100% | Automatic  |
| 15 | Print Media<br><br>Publishing of newspaper and periodicals dealing with news and current affairs   | 26%  | Government   |

|    |  |      |   |
|----|--|------|---|
| 16 | Print Media<br>Publication of Indian editions of foreign magazines dealing with news and current affairs   | 26%  | Government  |
| 17 | Print Media<br>Publishing or printing of Scientific and Technical Magazine or specialty journals or periodicals, subject to compliance with the legal framework as applicable and guidelines issued in this regard from time to time by Ministry of Information and Broadcasting.      | 100% | Government  |
| 18 | Print Media<br>Publication of facsimile edition of foreign newspapers  | 100% | Government  |
|    | Uploading/ Streaming of News & Current Affairs through Digital Media 26% Government  | 26%  | Government  |
| 19 | Airports(Greenfield projects 100% Automatic )  | 100% | Automatic   |
| 20 | Airports(Existing projects 100% Automatic )  | 100% | Automatic   |
| 21 | Scheduled Air Transport Service/ Domestic Scheduled Passenger<br>(i) Airline<br>(ii) Regional Air Transport Service  | 100% | Automatic up to 49% Government route beyond 49%(Automatic up to 100% for NRI's and OCI's) |
| 22 | Non-Scheduled Air Transport Service  | 100% | Automatic   |
| 23 | Helicopter service or seaplane services requiring Directorate General of Civil Aviation approval   | 100% | Automatic   |
| 24 | Civil Aviation sector<br>Ground Handling Services subject to sectoral regulations and security clearance   | 100% | Automatic   |
| 25 | Civil Aviation sector<br>Maintenance and Repair organizations; flying training institutes and technical training institutions  | 100% | Automatic   |
| 26 | Construction-development projects (which shall include development of townships, construction of residential/ commercial premises, roads or bridges, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure, townships) | 100% | Automatic   |
| 27 | Industrial Parks   | 100% | Automatic   |
| 28 | Satellites - Establishment and operation   |      |   |
| 29 | Satellites Establishment and operation, subject to the sectoral guidelines of Department of Space/ ISRO  | 100% | Government  |
| 30 | Private Security Agencies  | 49%  | Government  |

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|----|--|-------|---|
| 31 | All telecom services including Telecom Infrastructure Providers Category-I, viz. Basic, Cellular, United Access Services, Unified license (Access services), Unified License, National/ International Long Distance, Commercial V-Sat, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communications Services (GMPCS), all types of ISP licenses, Voice Mail/Audiotex/ UMS, Resale of IPLC, Mobile Number Portability services, Infrastructure Provider Category-I (providing dark fibre, right of way, duct space, tower) except Other Service Providers.   | 100%  | Automatic up to 49%;<br>Government route beyond 49%               |
| 32 | Cash and Carry Wholesale Trading/ Wholesale Trading (including sourcing from MSEs)   | 100%  | Automatic   |
| 33 | B2B E-commerce activities  | 100%  | Automatic   |
| 34 | Market place model of e-commerce   | 100 % | Automatic   |
| 35 | Sale of services through e-commerce shall be under automatic route subject to the sector specific conditions, applicable laws/ regulations, security and other conditionalities.   |       |   |
| 36 | Single Brand Product Retail Trading  | 100%  | Automatic up to 49%;<br>Government route beyond 49%               |
| 37 | Multi Brand Retail Trading (MBRT)  | 51%   | Government  |
| 38 | Duty Free Shops  | 100%  | Automatic   |
| 39 | Pharmaceuticals( Greenfield)   | 100%  | Automatic   |
| 40 | Pharmaceuticals (Brownfield)   | 100%  | Automatic up to 74%;<br>Government route beyond 74%               |
| 41 | Railway Infrastructure<br><br>Construction, operation and maintenance of the following:<br><br>(i) Suburban corridor projects through PPP, (ii) high-speed train projects, (iii) Dedicated freight lines, (iv) Rolling stock including train sets, and locomotives/ coaches manufacturing and maintenance facilities, (v) Railway Electrification, (vi) Signalling systems, (vii) Freight terminals, (viii) Passenger terminals, (ix) Infrastructure in industrial park pertaining to railway line/ sidings including electrified railway lines and connectivity to main railway line and (x) Mass Rapid Transport Systems | 100%  | Automatic   |
| 42 | Banking - Private sector   | 74%   | Automatic up to 49%;<br>Government route beyond 49% and up to 74% |

|    |   |                 |            |
|----|---|-----------------|------------|
| 43 | Banking - Public Sector subject to Banking Companies (Acquisition & Transfer of Undertakings) Acts, 1970/ 80. This ceiling is also applicable to the State Bank of India.   | 20%             | Government |
| 44 | Infrastructure companies in Securities Markets, namely, stock exchanges, commodity derivative exchanges, depositories and clearing corporations, in compliance with Securities and Exchange Board of India Regulations  | 49%             | Automatic  |
| 45 | Power Exchanges under the Central Electricity Regulatory Commission (Power Market) Regulations, 2010  | 49%             | Automatic  |
| 46 | Credit Information Companies  | 100%            | Automatic  |
| 47 | Insurance Company<br><br>Intermediaries or other Insurance Intermediaries including insurance brokers, re-insurance brokers, insurance consultants, corporate agents, third party administrator, Surveyors and Loss Assessors and such other entities as may be notified by the Insurance Regulatory and Development Authority Act. | 74%<br><br>100% | Automatic  |
| 48 | Pension Sector  | 49%             | Automatic  |
| 49 | Other Financial Services  | 100%            | Automatic  |

### Investment by a person resident outside India in a Limited Liability Partnership (LLP)

According to Rule 6(b) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India, other than a citizen of Bangladesh or Pakistan or an entity incorporated in Bangladesh or Pakistan, may invest either by way of capital contribution or by way of acquisition or transfer of profit shares of an LLP, in the manner and subject to the following terms and conditions:

- A person resident outside India (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India (other than an entity incorporated in Pakistan or Bangladesh), not being a Foreign Portfolio Investor (FPI) or a Foreign Venture Capital Investor (FVCI), may contribute to the capital of an LLP operating in sectors or activities where foreign investment up to 100 per cent is permitted under automatic route and there are no FDI linked performance conditions.
- Investment by way of "profit share" shall fall under the category of reinvestment of earnings.
- Investment in a LLP is subject to the compliance of the conditions of Limited Liability Partnership Act, 2008.
- A company having foreign investment, engaged in a sector where foreign investment up to 100 percent is permitted under the automatic route and there are no FDI linked performance conditions, may be converted into a LLP under the automatic route.
- A LLP having foreign investment, engaged in a sector where foreign investment up to 100 per cent is permitted under the automatic route and there are no FDI linked performance conditions, may be converted into a company under the automatic route.
- Investment in a LLP either by way of capital contribution or by way of acquisition or transfer of profit shares, should not be less than the fair price worked out as per any valuation norm which is internationally accepted or adopted as per market practice (hereinafter referred to as "fair price of capital contribution or profit share of a LLP") and a valuation certificate to that effect shall be issued by the Chartered Accountant or by a practising Cost Accountant or by an approved valuer from the panel maintained by the Central Government.
- In case of transfer of capital contribution or profit share from a person resident in India to a person resident outside India, the transfer shall be for a consideration not less than the fair price of capital contribution or profit share of a LLP. Further, in case of transfer of capital contribution or profit share from a person resident

outside India to a person resident in India, the transfer shall be for a consideration which is not more than the fair price of the capital contribution or profit share of an LLP.

- (h) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

### **Investment by a person resident outside India in an Investment Vehicle**

According to Rule 6 (c) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India, other than a citizen of Bangladesh or Pakistan or an entity incorporated in Bangladesh or Pakistan, may invest in units of an investment vehicle, in the manner and subject to the following terms and conditions:

- (1) A person resident outside India (other than a citizen of Pakistan or Bangladesh) or an entity incorporated outside India (other than an entity incorporated in Pakistan or Bangladesh) may invest in units of Investment Vehicles.
- (2) A person resident outside India who has acquired or purchased units in accordance with this Schedule may sell or transfer in any manner or redeem the units as per regulations framed by the Securities and Exchange Board of India or directions issued by the Reserve Bank.
- (3) An Investment vehicle may issue its units to a person resident outside India against swap of equity instruments of a Special Purpose Vehicle (SPV) proposed to be acquired by such Investment Vehicle.
- (4) Investment made by an Investment Vehicle into an Indian entity shall be reckoned as indirect foreign investment for the investee Indian entity if the Sponsor or the Manager or the Investment Manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.

Provided that for sponsors or managers or investment managers organised in a form other than companies or LLPs, Securities and Exchange Board of India shall determine whether the sponsor or manager or investment manager is foreign owned and controlled.

(Explanation: "Control" of the AIF should be in the hands of "sponsors" and "managers or investment managers", with the general exclusion to others. In case the "sponsors" and "managers or investment managers" of the AIF are individuals, for the treatment of down-stream investment by such AIF as domestic, "sponsors" and "manager or investment managers" should be resident Indian citizens.

- (5) An Alternative Investment Fund Category III which has received any foreign investment shall make portfolio investment in only those securities or instruments in which a FPI is allowed to invest under the Act or rules or regulations made thereunder.
- (6) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

### **Investment in Depository Receipts by a person resident outside India**

According to Rule 6 (d) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India may invest in the depository receipts (DRs) issued by foreign depositories against eligible securities in the manner and subject to the following terms and conditions :

- (a) Any security or unit in which a person resident outside India is allowed to invest under these rules shall be eligible instruments for issue of Depository Receipts in terms of Depository Receipts Scheme, 2014 (DR Scheme, 2014).
- (b) A person shall be eligible to issue or transfer eligible instruments to a foreign depository for the purpose of issuance of depository receipts in accordance with the DR Scheme, 2014 and guidelines issued by the Central Government in this regard.
- (c) A domestic custodian may purchase eligible instruments on behalf of a person resident outside India, for the purpose of converting the instruments so purchased into depository receipts in terms of DR Scheme, 2014.

- (d) The aggregate of eligible instruments which may be issued or transferred to foreign depositories, along with eligible instruments already held by persons resident outside India, shall not exceed the limit on foreign holding of such eligible instruments under the Act, rules or regulations framed thereunder.
- (e) The eligible instruments shall not be issued or transferred to a foreign depository for the purpose of issuing depository receipts at a price less than the price applicable to a corresponding mode of issue or transfer of such instruments to domestic investors under the applicable laws.

Depository Receipts issued under the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 shall be deemed to have been issued under the corresponding provisions of DR Scheme 2014 and have to comply with the provisions specified in this Schedule.

### **Acquisition through rights issue or bonus issue**

Rule 7 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a person resident outside India and having investment in an Indian company may make investment in equity instruments (other than share warrants) issued by such company as a rights issue or a bonus issue, provided that,-

- (a) the offer made by the Indian company is in compliance with the provisions of the Companies Act, 2013;
- (b) such issue shall not result in a breach of the sectoral cap applicable to the company;
- (c) the shareholding on the basis of which the rights issue or the bonus issue has been made must have been acquired and held as per the provisions of FEM(Non-debt Instruments) Rules, 2019;
- (d) in case of a listed Indian company, the rights issue to persons resident outside India shall be at a price determined by the company;
- (e) in case of an unlisted Indian company, the rights issue to persons resident outside India shall not be at a price less than the price offered to persons resident in India;
- (f) such investment made through rights issue or bonus issue shall be subject to the conditions as are applicable at the time of such issue;
- (g) the mode of payment and attendant conditions for such transactions shall be specified by the Reserve Bank.
- (h) an individual who is a person resident outside India exercising a right which was issued when he or she was a person resident in India shall hold the equity instruments (other than share warrants) so acquired on exercising the option on a non-repatriation basis.

It may be noted that the above conditions shall also be applicable in case a person resident outside India makes investment in equity instruments (other than share warrants) issued by an Indian company as a rights issue that are renounced by the person to whom it was offered.

### **Issue of Employees Stock Options and sweat equity shares to persons resident outside India**

Rule 8 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that an Indian company may issue “employees’ stock option” and/ or “sweat equity shares” to its employees or directors or employees or directors of its holding company or joint venture or wholly owned overseas subsidiary or subsidiaries who are resident outside India:

Provided that. -

- (a) the scheme has been drawn either in terms of regulations issued under the Securities and Exchange Board of India Act, 1992 or the Companies (Share Capital and Debentures) Rules, 2014, as the case may be;
- (b) the “employee’s stock option” or “sweat equity shares” so issued under the rules or regulations are in compliance with the sectoral cap applicable to the said company;
- (c) the issue of “employee’s stock option” or “sweat equity shares” in a company where investment by a person resident outside India is under the approval route shall require prior government approval and issue of “employee’s stock option” or “sweat equity shares” to a citizen of Bangladesh or Pakistan shall require prior government approval :

Provided further that an individual who is a person resident outside India exercising an option which was issued when he or she was a person resident in India shall hold the shares so acquired on exercising the option on a non-repatriation basis.

### Transfer of equity instruments of an Indian company by or to a person resident outside India

As per Rule 9 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India holding equity instruments of an Indian company or units in accordance with the FEM (Non-debt Instruments) Rules, 2019 or a person resident in India, may transfer such equity instruments or units so held by him in compliance with the conditions, if any, specified in the Schedules of the FEM (Non-debt Instruments) Rules, 2019 and subject to the prescribed terms and conditions.

Rule 9(1) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a person resident outside India, not being a non-resident Indian or an overseas citizen of India or an erstwhile overseas corporate body may transfer by way of sale or gift the equity instruments of an Indian company or units held by him to any person resident outside India;

Explanation: It shall also include transfer of equity instruments of an Indian company pursuant to liquidation, merger, de-merger and amalgamation of entities or companies incorporated or registered outside India.

Provided that.-

- (i) prior government approval shall be obtained for any transfer in case the company is engaged in a sector which requires government approval;
- (ii) where the equity instruments are held by the person resident outside India on a non-repatriable basis, the transfer by way of sale where the transferee intends to hold the equity instruments on a repatriable basis, shall be in compliance with and subject to the adherence to entry routes, sectoral caps or investment limits, as specified in these rules and attendant conditionalities for such investment, pricing guidelines, documentation and reporting requirements for such transfers, as may be specified by the Reserve Bank from time to time.

Rule 9(2) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a person resident outside India, holding equity instruments of an Indian company or units in accordance with these rules may transfer the same to a person resident in India by way of sale or gift or may sell the same on a recognised stock exchange in India in the manner specified by the Securities and Exchange Board of India.

Provided that. -

- (i) the transfer by way of sale shall be in compliance with and subject to the adherence to pricing guidelines, documentation and reporting requirements for such transfers as may be specified by the Reserve Bank in consultation with the Central Government from time to time;
- (ii) where the equity instruments are held by the person resident outside India on a non-repatriable basis, conditions at item (i) of the proviso shall not apply.

According to Rule 9(3) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 a person resident in India holding equity instruments of an Indian company or units, may transfer the same to a person resident outside India by way of sale, subject to the adherence to entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions as applicable for investment by a person resident outside India and documentation and reporting requirements for such transfers as may be specified by the Reserve Bank in consultation with the Central Government from time to time;

Rule 9(4) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a person resident in India holding equity instruments or units of an Indian company on a non- repatriation basis may transfer the same to a person resident outside India by way of gift with the prior approval of the Reserve Bank, in the manner prescribed, and subject to the following conditions, namely:-

- (i) the donee is eligible to hold such a security under the Schedules of these Rules;
- (ii) the gift does not exceed five percent of the paid up capital of the Indian company or each series of debentures or each mutual fund scheme;

Explanation: The five percent of the paid up capital of the Indian company or each series of debentures or each mutual fund scheme will be on cumulative basis by a single person to another single person.

- (iii) the applicable sectoral cap in the Indian company is not breached;
- (iv) the donor and the done shall be “relatives” within the meaning in clause (77) of section 2 of the Companies Act, 2013;
- (v) the value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift during the financial year does not exceed the rupee equivalent of fifty- thousand US Dollars;
- (vi) such other conditions as considered necessary in public interest by the Central Government.

Rule 9(5) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a person resident outside India holding equity instruments of an Indian company containing an optionality clause in accordance with these rules and exercising the option or right, may exit without any assured return, subject to the pricing guidelines prescribed in these rules and a minimum lock-in period of one year or minimum lock-in period as prescribed in these rules, whichever is higher.

Rule 9(6) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that in case of transfer of equity instruments between a person resident in India and a person resident outside India, an amount not exceeding twenty five percent of the total consideration,-

- (i) may be paid by the buyer on a deferred basis within a period not exceeding eighteen months from the date of the transfer agreement; or
- (ii) may be settled through an escrow arrangement between the buyer and the seller for a period not exceeding eighteen months from the date of the transfer agreement; or
- (iii) may be indemnified by the seller for a period not exceeding eighteen months from the date of the payment of the full consideration, if the total consideration has been paid by the buyer to the seller:
- (iv) Provided that the total consideration finally paid for the shares shall be compliant with the applicable pricing guidelines.

Rule 9(7) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that in case of transfer of equity instruments between a person resident in India and a person resident outside India, a person resident outside India may open an escrow account in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016 and such escrow account may be funded by way of inward remittance through banking channels and/ or by way of guarantee issued by an authorised dealer bank, subject to the terms and conditions as specified in the Foreign Exchange Management (Guarantees) Regulations, 2000.

According to Rule 9(8) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 the transfer of equity instruments of an Indian company or units of an investment vehicle by way of pledge is subject to the following terms and conditions, namely :-

- (i) any person being a promoter of a company registered in India (borrowing company), which has raised external commercial borrowing in compliance with the Foreign Exchange Management (Borrowing and Lending in Foreign Exchange) Regulations, 2000 may pledge the shares of the borrowing company or that of its associate resident companies for the purpose of securing the external commercial borrowing raised by the borrowing company subject to the following further conditions, namely:-
  - (a) the period of such pledge shall be co-terminus with the maturity of the underlying external commercial borrowing;
  - (b) in case of invocation of pledge, transfer shall be made in accordance with these rules and directions issued by the Reserve Bank;
  - (c) the statutory auditor has certified that the borrowing company shall utilise or has utilised the proceeds of the external commercial borrowing for the permitted end-use only;

- (d) no person shall pledge any such share unless a no-objection has been obtained from an authorised dealer bank that the above conditions have been complied with;
- (ii) any person resident outside India holding equity instruments in an Indian company or units of an investment vehicle may pledge the equity instruments or units, as the case may be,
  - (a) in favour of a bank in India to secure the credit facilities being extended to such Indian company for bona fide purposes,
  - (b) in favour of an overseas bank to secure the credit facilities being extended to such person or a person resident outside India who is the promoter of such Indian company or the overseas group company of such Indian company,
  - (c) in favour of a non-banking financial company registered with the Reserve Bank to secure the credit facilities being extended to such Indian company for bona fide purposes,
  - (d) subject to the authorised dealer bank satisfying itself of the compliance of the conditions stipulated by the Reserve Bank in this regard;
- (iii) in case of invocation of pledge, transfer of equity instruments of an Indian company or units shall be in accordance with entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions at the time of creation of pledge.

### INVESTMENT BY FOREIGN PORTFOLIO INVESTOR (FPI)

Rule 10 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a FPI may purchase or sell equity instruments of an Indian company which is listed or to be listed on a recognised stock exchange in India, and/or may purchase or sell securities other than equity instruments, in the manner and subject to the specified terms and conditions.

A FPI may purchase, hold, or sell Indian Depository Receipts (IDRs) of companies resident outside India and issued in the Indian capital market, in the manner and subject to the terms and conditions prescribed.

#### Purchase or sale of equity instruments by Foreign Portfolio Investors

##### (a) Purchase and sale of equity instruments.-

A FPI may purchase or sell equity instruments of an Indian company listed or to be listed on a recognised stock exchange in India subject to the following conditions, namely:-

- (i) The total holding by each FPI or an investor group, shall be less than 10 percent of the total paid- up equity capital on a fully diluted basis or less than 10 percent of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company and the total holdings of all FPIs put together, including any other direct and indirect foreign investments in the Indian company permitted under the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, shall not exceed 24 per cent of paid-up equity capital on a fully diluted basis or paid up value of each series of debentures or preference shares or share warrants. The said limit of 10 percent and 24 percent shall be called the individual and aggregate limit, respectively.
- (ii) With effect from the 1st April, 2020, the aggregate limit shall be the sectoral caps applicable to the Indian company as laid out in Schedule I of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, with respect to its paid-up equity capital on a fully diluted basis or such same sectoral cap percentage of paid up value of each series of debentures or preference shares or share warrants:

Provided that the aggregate limit as provided above may be decreased by the Indian company concerned to a lower threshold limit of 24% or 49% or 74% as deemed fit, with the approval of its Board of Directors and its General Body through a resolution and a special resolution, respectively before 31st March, 2020:

Provided further, that the Indian company which has decreased its aggregate limit to 24% or 49% or 74%, may increase such aggregate limit to 49% or 74% or the sectoral cap or statutory ceiling respectively as deemed fit, with the approval of its Board of Directors and its General Body through a resolution and a special resolution, respectively:

Provided also that once the aggregate limit has been increased to a higher threshold, the Indian company cannot reduce the same to a lower threshold:

Provided also that the aggregate limit with respect to an Indian company in a sector where FDI is prohibited shall be 24 per cent.

Explanation: In case, two or more FPI's including foreign Governments/their related entities are having common ownership, directly or indirectly, of more than fifty percent or common control, all such FPI's shall be treated as forming part of an investor group. Control includes the right to appoint majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of shareholding or management rights or shareholders agreements or voting agreements or in any other manner.

- (iii) The FPIs investing in breach of the prescribed limit shall have the option of divesting their holdings within 5 trading days from the date of settlement of the trades causing the breach. In case the FPI chooses not to divest, then the entire investment in the company by such FPI and its investor group shall be considered as investment under Foreign Direct Investment (FDI) and the FPI and its investor group shall not make further portfolio investment in the company concerned. The FPI, through its designated custodian, shall bring the same to the notice of the depositories as well as the concerned company for effecting necessary changes in their records, within 7 trading days from the date of settlement of the trades causing the breach. The breach of the said aggregate or sectoral limit on account of such acquisition for the period between the acquisition and sale or conversion to FDI within the prescribed time, shall not be reckoned as a contravention under these Rules.
- (iv) The investment by foreign Government agencies shall be clubbed with the investment by the foreign Government or its related entities for the purpose of calculation of 10 percent limit for FPI investments in a single company, if they form part of an investor group. However, certain foreign Government agencies and its related entities may be exempt from such clubbing requirements and other investment conditions either by way of an agreement or treaty with other sovereign governments or by an order of the Central Government.
- (v) A FPI may purchase equity instruments of an Indian company through public offer or private placement, subject to the individual and aggregate limits specified under the Schedule II of Foreign Exchange Management (Non-debt Instruments) Rules, 2019:

Provided that -

- (a) in case of public offer, the price of the shares to be issued is not less than the price at which
- (b) shares are issued to residents, and in case of issue by private placement, the price is not less than-
  - (a) the price arrived in terms of guidelines issued by the Securities and Exchange Board of India, or
  - (b) the fair price worked out as per any internationally accepted pricing methodology for valuation of shares on arm's length basis, duly certified by a Merchant Banker or Chartered Accountant or a practicing Cost Accountant, as applicable registered with the Securities and Exchange Board of India
- (vi) A FPI may, undertake short selling as well as lending and borrowing of securities subject to such conditions as may be stipulated by the Reserve Bank and the Securities and Exchange Board of India from time to time.
- (vii) Investments made under this Schedule shall be subject to the limits and margin requirements specified by the Reserve Bank or the Securities and Exchange Board of India as well as the stipulations regarding collateral securities as specified by the Reserve Bank from time to time.

**(b) Purchase or sale of securities other than equity instruments by FPIs.-**

- (i) A FPI may purchase units of domestic mutual funds or Category III Alternative Investment Fund or offshore fund for which no objection is issued in accordance with the SEBI (Mutual Fund) Regulations, 1996, which in turn invest more than 50 percent in equity instruments on repatriation basis subject to the terms and conditions specified by the Securities and Exchange Board of India and the Reserve Bank.

- (ii) An FPI may purchase units of REITs and InVITs on repatriation basis subject to the terms and conditions specified by the Securities and Exchange Board of India.

A FPI may purchase, hold, or sell Indian Depository Receipts (IDRs) of companies resident outside India and issued in the Indian capital market, in the manner and subject to the terms and conditions as prescribed in Schedule X of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

### Transfer of equity instruments of an Indian company by FPI

According to Rule 11 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a FPI holding equity instruments of an Indian company or units, may transfer such equity instruments or units held by him in compliance with the conditions, if any, specified and by the Securities and Exchange Board of India:

Provided that, - (i) prior Government approval shall be obtained for any transfer in case the company is engaged in a sector which requires the Government approval; (ii) where the acquisition of equity instruments by FPI has resulted in a breach of the applicable aggregate FPI limits or sectoral limits the provisions of item (iii) of subparagraph (a) of paragraph (1) of Schedule II to the Rules shall apply.

## INVESTMENT BY NON-RESIDENT INDIAN OR AN OVERSEAS CITIZEN OF INDIA

### Investment by NRI or OCI - A NRI or an OCI may make investments as under:-

Rule 12(1) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a NRI or an OCI may, on repatriation basis, purchase or sell equity instruments of a listed Indian company and other securities in the manner and subject to the terms and conditions prescribed in Schedule III of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

### Investments by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on repatriation basis

#### (1) Purchase or sale of equity instruments of a listed Indian company

A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may purchase or sell equity instruments of a listed Indian company on repatriation basis, on a recognized stock exchange in India, subject to the following conditions, namely :-

- (a) NRIs or OCIs may purchase and sell equity instruments through a branch designated by an Authorized Dealer for the purpose;
- (b) The total holding by any individual NRI or OCI shall not exceed 5 percent of the total paid-up equity capital on a fully diluted basis or shall not exceed 5 percent of the paid-up value of each series of debentures or preference shares or share warrants issued by an Indian company and the total holdings of all NRIs and OCIs put together shall not exceed ten percent of the total paid-up equity capital on a fully diluted basis or shall not exceed ten percent of the paid-up value of each series of debentures or preference shares or share warrants:

Provided that the aggregate ceiling of 10 percent may be raised to 24 percent if a special resolution to that effect is passed by the General Body of the Indian company.

#### (2) Purchase or sale of units of domestic mutual funds

A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may without limit purchase or sell units of domestic mutual funds which invest more than 50 percent in equity.

#### (3) Purchase or sale of shares in public sector enterprises

A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may, without limit purchase or sell shares in public sector enterprises being disinvested by the Central Government, provided the purchase is in accordance with the terms and conditions stipulated in the notice inviting bids.

#### **(4) Subscription to National Pension System.-**

A NRI or an OCI may subscribe to the National Pension System governed and administered by Pension Fund Regulatory and Development Authority (PFRDA), provided such person is eligible to invest as per the provisions of the Pension Fund Regulatory and Development Authority Act. The annuity/ accumulated saving will be repatriable:

Provided that NRIs or OCIs may offer such instruments as permitted by the Reserve Bank from time to time as collateral to the recognised Stock Exchanges in India for their transactions in exchange traded derivative contracts as prescribed in Clause 12(2) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

- (5) The mode of payment and attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

#### **Investment by NRI or OCI on non-repatriation basis**

Rule 12(2) of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a NRI or an OCI may, on non-repatriation basis, purchase or sell equity instruments of an Indian company or other securities or contribute to the capital of a LLP or a firm or proprietary concern, in the manner and subject to the terms and conditions specified in Schedule IV of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

##### **A. Purchase or sale of equity instruments of an Indian company or units or contribution to the capital of a LLP by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on Non-repatriation basis.**

###### **(1) Purchase or sale of equity instruments or convertible notes or units or contribution to the capital of a LLP.**

- (a) A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI), including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs, may purchase or contribute, as the case may be, on non-repatriation basis the following, namely:
  - (i) a equity instrument issued by a company without any limit either on the stock exchange or outside it;
  - (ii) units issued by an investment vehicle without any limit, either on the stock exchange or outside it;
  - (iii) The capital of a Limited Liability Partnership without any limit;
  - (iv) convertible notes issued by a startup company in accordance with these rules.
- (b) The investment detailed at sub-paragraph (a) of paragraph (1) above shall be deemed to be domestic investment at par with the investment made by residents.

###### **(2) Purchase or sale of units of domestic mutual funds**

A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may without limit purchase or sell units of domestic mutual funds on non-repatriation basis which invest more than 50% in equity.

###### **(3) Prohibition on purchase of equity instruments of certain companies.**

Notwithstanding anything contained in paragraph 1, a NRI or an OCI including a company, a trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs, shall not make any investment, under this Schedule, in equity instruments or units of a Nidhi company or a company engaged in agricultural or plantation activities or real estate business or construction of farm houses or dealing in transfer of development rights.

Explanation: Real estate business shall have the same meaning as specified in sub-paragraph (b) of paragraph (3) of Schedule 1 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

- (4) The mode of payment and attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

###### **(B) Investment in a firm or a proprietary concern.**

- (1) Contribution to capital of a firm or a proprietary concern.

A NRI or an OCI may invest on a non-repatriation basis, by way of contribution to the capital of a firm or a proprietary concern in India provided such firm or proprietary concern is not engaged in any agricultural or plantation activity or print media or real estate business.

Explanation: Real estate business shall have the same meaning as specified in sub paragraph (b) of paragraph (3) of Schedule I.

- (2) The mode of payment and attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

Note: A NRI or an OCI may trade or invest in all exchange traded derivative contracts approved by the Securities and Exchange Board of India from time to time subject to the limits specified by Securities and Exchange Board of India and conditions prescribed in Schedule III of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

A NRI or an OCI may purchase, hold, or sell Indian Depository Receipts (IDRs) of companies resident outside India and issued in the Indian capital market, in the manner and subject to the terms and conditions specified in Schedule X of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

### Transfer of equity instruments by NRI or OCI

Rule 13(1) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a NRI or an OCI holding equity instruments of an Indian company or units in accordance with these rules may transfer such equity instruments or units so held by him in compliance with the conditions, if any, prescribed in the Schedules of these rules and subject to the terms and conditions prescribed hereunder:

- (1) A NRI or an OCI holding equity instruments of an Indian company or units on repatriation basis may transfer the same by way of sale or gift to any person resident outside India :

Provided that,-

- (i) prior Government approval shall be obtained for any transfer in case the company is engaged in a sector which requires Government approval;
- (ii) where the acquisition of equity instruments by an NRI or an OCI under the provisions of Schedule III of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 has resulted in a breach of the applicable aggregate NRI or OCI limit or sectoral limits, the NRI or the OCI shall sell such equity instruments to a person resident in India eligible to hold such instruments within the time stipulated by the Reserve Bank of India in consultation with the Central Government and the breach of the said aggregate or sectoral limit on account of such acquisition for the period between the acquisition and sale, provided the sale is within the prescribed time, shall not be reckoned as a contravention under these rules.

Rule 13(2) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a NRI or an OCI or an eligible investor holding equity instruments of an Indian company or units on a non- repatriation basis, may transfer the same to a person resident outside India by way of sale, subject to the adherence to entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions as applicable for investment by a person resident outside India and documentation and reporting requirements for such transfers as may be specified by the Reserve Bank in consultation with the Central Government from time to time.

Provided that the entry routes, sectoral caps or investment limits, pricing guidelines and other attendant conditions shall not apply in case the transfer is to an NRI or an OCI or an eligible investor under Schedule IV of these rules acquiring such investment.

As per Rule 13(3) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 a NRI or an OCI or an eligible investor holding equity instruments or units of an Indian company on a non- repatriation basis may transfer the same to a person resident outside India by way of gift with the prior approval of the Reserve Bank of India, in the manner prescribed, and subject to the following conditions, namely:-

- (i) the donee is eligible to hold such a security under relevant Schedules of these rules;

- (ii) the gift does not exceed five percent of the paid up capital of the Indian company or each mutual fund scheme;

Explanation: The five percent shall be on cumulative basis by a single person to another single person.

- (iii) the applicable sectoral cap in the Indian company is not breached;
- (iv) the donor and the donee shall be “relatives” within the meaning in clause (77) of section 2 of the Companies Act, 2013;
- (v) the value of security to be transferred by the donor together with any security transferred to any person residing outside India as gift during the financial year does not exceed the rupee equivalent of USD 50000;
- (vi) such other conditions as may be considered necessary in public interest by the Central Government.

Rule 13(4) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a NRI or an OCI or an eligible investor holding equity instruments of an Indian company or units on a non-repatriation basis, may transfer the same by way of gift to an NRI or an OCI or an eligible investor who shall hold it on a non-repatriable basis.

Rule 13(5) of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that an erstwhile OCB may transfer equity instruments subject to the directions issued by the Reserve Bank of India from time to time in this regard.

Explanation: “Overseas Corporate Body (OCB)” means an entity de-recognised through Foreign Exchange Management [Withdrawal of General Permission to Overseas Corporate Bodies (OCBs)] Regulations, 2003.

## INVESTMENT BY OTHER NON-RESIDENT INVESTORS

### Investment in securities by other non-resident investors

According to Rule 14 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, the other non-resident investors may make investments in securities in the manner and subject to the terms and conditions specified in Schedule V of Foreign Exchange Management (Non-debt Instruments) Rules, 2019.

### Permission to other non-resident investors for purchase of securities

- (1) Long term investors like Sovereign Wealth Funds (SWFs), Multilateral Agencies, Endowment Funds, Insurance Funds, Pension Funds and Foreign Central Banks may purchase securities subject to such terms and conditions as may be specified by the Reserve Bank and the Securities and Exchange Board of India.
- (2) “Eligible Foreign Entity (EEE)” as defined in SEBI circular dated the 9th October 2018 and having actual exposure to Indian physical commodity market may participate in domestic commodity derivative markets in accordance with framework specified by the Securities and Exchange Board of India.
- (3) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.

### Transfer of securities by other non-resident investors

Rule 15 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that the other non-resident investors, holding securities in accordance with these rules, may transfer the securities subject to such terms and conditions prescribed in Schedule V of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 and as specified by the Securities and Exchange Board of India and the Reserve Bank.

## INVESTMENT BY FOREIGN VENTURE CAPITAL INVESTOR (FVCI)

According to Rule 16 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 a Foreign Venture Capital Investor (FVCI) may make investments in the manner and subject to the terms and conditions specified in Schedule VII of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 specified below:

- (1) Subject to the terms and conditions as may be laid down by the Central Government, a Foreign Venture Capital Investor (FVCI) may purchase, -

- (i) securities, issued by an Indian company engaged in any sector mentioned in paragraph (4) of this Schedule and whose securities are not listed on a recognised stock exchange at the time of issue of the said securities;
- (ii) units of a Venture Capital Fund (VCF) or of a Category I Alternative Investment Fund (Cat-I AIF) or units of a scheme or of a fund set up by a VCF or by a Cat-I AIF.
- (iii) equity or equity linked instrument or debt instrument issued by an Indian 'start-up' irrespective of the sector in which the start-up is engaged. The definition of 'start-up' shall be as per Department for Promotion of Industry and Internal Trade's Notification No. G.S.R. 364(E), dated the 11th April, 2018.

Provided that if the investment is in equity instruments, then the sectoral caps, entry routes and attendant conditions shall apply.

- (2) A FVCI may purchase the securities or instruments mentioned above either from the issuer of these securities/instruments or from any person holding these securities or instruments. The FVCI may invest in securities on a recognised stock exchange subject to the provisions of the Securities and Exchange Board of India (FVCI) Regulations, 2000.
- (3) The FVCI may acquire, by purchase or otherwise, from, or transfer, by sale or otherwise, to, any person resident in or outside India, any security or instrument it is allowed to invest in, at a price that is mutually acceptable to the buyer and the seller/ issuer. The FVCI may also receive the proceeds of the liquidation of VCFs or of Cat-I AIFs or of schemes or funds set up by the VCFs or Cat-I AIFs.
- (4) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank of India
- (5) List of sectors in which a Foreign Venture Capital Investor is allowed to invest is as follows :-
  - (a) biotechnology;
  - (b) IT related to hardware and software development;
  - (c) nanotechnology;
  - (d) seed research and development;
  - (e) research and development of new chemical entities in pharmaceutical sector.
  - (f) dairy industry;
  - (g) poultry industry;
  - (h) production of bio-fuels;
  - (i) hotel-cum-convention centres with seating capacity of more than three thousand;
  - (j) Infrastructure sector. The term "Infrastructure Sector" has the same meaning as given in the Harmonised Master List of Infrastructure sub-sectors approved by Government of India vide notification F. No. 13/06/2009-INF, dated the March 27, 2012 as amended or updated.

### Transfer of equity instruments of an Indian company by or to a FVCI

Rule 17 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a FVCI holding equity instruments of an Indian company or units in accordance with these rules or a person resident in India, may transfer such equity instruments or units so held by him in compliance with the conditions, if any, prescribed in Schedule VII of these rules and as specified by the Securities and Exchange Board of India and the Reserve Bank.

### ISSUE OF CONVERTIBLE NOTES BY AN INDIAN START-UP COMPANY

- (1) A person resident outside India (other than an individual who is citizen of Pakistan or Bangladesh or an entity which is registered or incorporated in Pakistan or Bangladesh), may purchase convertible notes issued by an Indian start-up company for an amount of twenty five lakh rupees or more in a single tranche.
- (2) A start-up company, engaged in a sector where investment by a person resident outside India requires Government approval, may issue convertible notes to a person resident outside India only with such approval.

Further, issue of equity shares against such convertible notes shall be in compliance with the entry route, sectoral caps, pricing guidelines and other attendant conditions for foreign investment.

- (3) The mode of payment and other attendant conditions for remittance of sale or maturity proceeds shall be specified by the Reserve Bank.
- (4) A NRI or an OCI may acquire convertible notes on non-repatriation basis in accordance with Schedule IV of these rules.
- (5) A person resident outside India may acquire or transfer by way of sale, convertible notes, from or to, a person resident in or outside India, provided the transfer takes place in accordance with the entry routes and pricing guidelines as prescribed for capital instruments. [Rule 18]

### MERGER OR DEMERGER OR AMALGAMATION OF INDIAN COMPANIES

- (1) Where a scheme of merger or amalgamation of two or more Indian companies or a reconstruction by way of demerger or otherwise of an Indian company, has been approved by the National Company Law Tribunal (NCLT) or competent authority, the transferee company or the new company, as the case may be, may issue equity instruments to the existing holders of the transferor company resident outside India, subject to the following conditions, namely:-
  - (a) the transfer or issue is in compliance with the entry routes, sectoral caps or investment limits, as the case may be, and the attendant conditionalities of investment by a person resident outside India. Provided that where the percentage is likely to breach the sectoral caps or the attendant conditionalities, the transferor company or the transferee or new company may obtain necessary approval from the Central Government.
  - (b) the transferor company or the transferee company or the new company shall not engage in any sector prohibited for investment by a person resident outside India.
- (2) where a scheme of merger or amalgamation of two or more Indian companies or a reconstruction by way of demerger or otherwise of an Indian company where any of the companies involved is listed on a recognised stock exchange in India, then the scheme of arrangement shall be in compliance with the SEBI (Listing Obligation and Disclosure Requirement) Regulations, 2015. [Rule 19]

### REPORTING REQUIREMENTS

The reporting requirements for any investment in India by a person resident in India shall be as specified by the Reserve Bank. [Rule 20]

### PRICING GUIDELINES

- (1) The pricing guidelines specified in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 shall not be applicable for any transfer by way of sale done in accordance with Securities and Exchange Board of India regulations where the pricing is specified by Securities and Exchange Board of India.
- (2) Unless otherwise prescribed in the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, the price of equity instruments of an Indian company,
  - (a) issued by such company to a person resident outside India shall not be less than :
    - (i) the price worked out in accordance with the Securities and Exchange Board of India guidelines in case of a listed Indian company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
    - (ii) the valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the Securities and Exchange Board of India or a practising Cost Accountant, in case of an unlisted Indian Company.

- (b) transferred from a person resident in India to a person resident outside India shall not be less than,-
- (i) the price worked out in accordance with the Securities and Exchange Board of India guidelines in case of a listed Indian company;
  - (ii) the price at which a preferential allotment of shares can be made under the Securities and Exchange Board of India Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009;
  - (iii) the valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the Securities and Exchange Board of India or a practising Cost Accountant, in case of an unlisted Indian company.
- (c) transferred by a person resident outside India to a person resident in India shall not exceed :
- (i) the price worked out in accordance with the relevant Securities and Exchange Board of India guidelines in case of a listed Indian company;
  - (ii) the price at which a preferential allotment of shares can be made under the Securities and Exchange Board of India Guidelines, as applicable, in case of a listed Indian company or in case of a company going through a delisting process as per the Securities and Exchange Board of India (Delisting of Equity Shares) Regulations, 2009 .
- Provided that the price is determined for such duration as specified in the Securities and Exchange Board of India Guidelines, preceding the relevant date, which shall be the date of purchase or sale of shares;
- (iii) the valuation of equity instruments done as per any internationally accepted pricing methodology for valuation on an arm's length basis duly certified by a Chartered Accountant or a Merchant Banker registered with the Securities and Exchange Board of India or a practising Cost Accountant, in case of an unlisted Indian company.
- Explanation: The guiding principle shall be that the person resident outside India is not guaranteed any assured exit price at the time of making such investment or agreement and shall exit at the price prevailing at the time of exit.
- (iv) in case of swap of equity instruments, subject to the condition that irrespective of the amount, valuation involved in the swap arrangement shall have to be made by a Merchant Banker registered with the Securities and Exchange Board of India or an investment banker outside India registered with the appropriate regulatory authority in the host country.
  - (v) where shares in an Indian company are issued to a person resident outside India in compliance with the provisions of the Companies Act, 2013, by way of subscription to Memorandum of Association, such investments shall be made at face value subject to entry route and sectoral caps.
  - (vi) in case of share warrants, their pricing and the price or conversion formula shall be determined upfront:

Provided that these pricing guidelines shall not be applicable for investment in equity instruments by a person resident outside India on a non-repatriation basis. [Rule 21]

## TAXES AND REMITTANCES OF SALE PROCEEDS

- (1) Taxes** - All transaction under these rules shall be undertaken through banking channels in India and subject to the payment of applicable taxes and other duties or levies in India.
- (2) Remittance of sale proceeds:**
- (a) No remittance of sale proceeds of an Indian security held by a person resident outside India shall be made otherwise than in accordance with these rules, the conditions prescribed in the relevant Schedule and as specified by the Reserve Bank.

- (b) An authorised dealer may allow the remittance of sale proceeds of a security (net of applicable taxes) to the seller of shares resident outside India :

Provided that -

- (i) the security was held by the seller on repatriation basis; and
- (ii) either the security has been sold in compliance with the pricing guidelines or the Reserve Bank's approval has been obtained in other cases for sale of the security and remittance of the sale proceeds thereof. [Rule 22]

## DOWNSTREAM INVESTMENT

- (1) Indian entity which has received indirect foreign investment shall comply with the entry route, sectoral caps, pricing guidelines and other attendant conditions as applicable for foreign investment.

Explanation: Downstream investment by an LLP not owned and not controlled by resident Indian citizens or owned or controlled by persons resident outside India is allowed in an Indian company operating in sectors where foreign investment up to one hundred percent is permitted under automatic route and there are no FDI linked performance conditions.

- (2) With effect from the 31st day of July, 2012, downstream investment(s) made under Corporate Debt Restructuring (CDR), or other loan restructuring mechanism, or in trading book, or for acquisition of shares due to defaults in loans, by a banking company, as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 ( 10 of 1949) incorporated in India, which is not owned and not controlled by resident Indian citizens or owned or controlled by persons resident outside India, shall not count towards indirect foreign investment, however, their strategic downstream investment shall be counted towards indirect foreign investment for the company in which such investment is being made.
- (3) Guidelines for calculating total foreign investment in Indian companies are as follows,-
  - (a) any equity holding by a person resident outside India resulting from conversion of any debt instrument under any arrangement shall be reckoned for total foreign investment;
  - (b) FCCBs and DRs having underlying of instruments in the nature of debt shall not be reckoned for total foreign investment;
  - (c) the methodology for calculating total foreign investment shall apply at every stage of investment in Indian companies and thus in each and every Indian company;
  - (d) for the purpose of downstream investment, the portfolio investment held as on 31st March of the previous financial year in the Indian company making the downstream investment shall be considered for computing its total foreign investment;
  - (e) indirect foreign investment received by a wholly owned subsidiary of an Indian company shall be limited to the total foreign investment received by the company making the downstream investment.
- (4) Downstream investment that is treated as indirect foreign investment for the investee entity shall be subject to the following conditions, namely:
  - (a) downstream investment shall have the approval of the Board of Directors as also a shareholders' Agreement, if any;
  - (b) for the purpose of downstream investment, the Indian entity making the downstream investment shall bring in requisite funds from abroad and not use funds borrowed in the domestic markets and the downstream investments may be made through internal accruals and for this purpose, internal accruals shall mean profits transferred to reserve account after payment of taxes. Further raising of debt and its utilisation shall be in compliance with the Act, rules or regulations made thereunder.
- (5) Equity instrument of an Indian company held by another Indian company which has received foreign investment and is not owned and not controlled by resident Indian citizens or is owned or controlled by persons resident outside India may be transferred to-

- (a) a person resident outside India, subject to the reporting requirements as specified by the Reserve Bank.
  - (b) a person resident in India subject to adherence to pricing guidelines;
  - (c) an Indian company which has received foreign investment and is not owned and not controlled by resident Indian citizens or owned or controlled by persons resident outside India.
- (6) The first level Indian company making downstream investment shall be responsible for ensuring compliance with the provisions of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 for the downstream investment made by it at second level and so on and so forth and such first level company shall obtain a certificate to this effect from its statutory auditor on an annual basis and such compliance of these rules shall be mentioned in the Director's report in the Annual Report of the Indian company. In case statutory auditor has given a qualified report, the same shall be immediately brought to the notice of the regional office of the Reserve Bank in whose jurisdiction the Registered Office of the company is located and shall also obtain acknowledgement from the Registered Office.

The provisions (5) and (6) stated above shall apply mutatis mutandis to a LLP.

Note: Downstream investment that is treated as indirect foreign investment for the investee entity made in accordance with the guidelines in existence prior to the 13th February, 2009 shall not require any modification to conform to these rules and all such investments, after the said date, shall come under the ambit of these rules. Downstream investment that is treated as indirect foreign investment for the investee entity made between the 13th February, 2009 and 21st June 2013 which is not in conformity with these rules shall have to be intimated to the Reserve Bank by 3rd October, 2013 for treating such cases as compliant with these Rules.

Explanation:- For the purposes of this rule,-

- (a) "ownership of an Indian company" shall mean beneficial holding of more than fifty percent of the equity instruments of such company and "ownership of an LLP" shall mean contribution of more than fifty percent in its capital and having majority profit share;
- (b) "company owned by resident Indian citizens" shall mean an Indian company where ownership is vested in resident Indian citizens and/ or Indian companies, which are ultimately owned and controlled by resident Indian citizens and "LLP owned by resident Indian citizens" shall mean an LLP where ownership is vested in resident Indian citizens and/ or Indian entities, which are ultimately owned and controlled by resident Indian citizens;
- (c) "company owned by persons resident outside India" shall mean an Indian company that is owned by persons resident outside India and "LLP owned by persons resident outside India" shall mean an LLP that is owned by persons resident outside India;
- (d) "control" shall mean the right to appoint majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement and for the purpose of LLP, "control" shall mean the right to appoint majority of the designated partners, where such designated partners, with specific exclusion to others, have control over all the policies of an LLP;
- (e) "company controlled by resident Indian citizens" means an Indian company, the control of which is vested in resident Indian citizens and/ or Indian companies which are ultimately owned and controlled by resident Indian citizens and "LLP controlled by resident Indian citizens" shall mean an LLP, the control of which is vested in resident Indian citizens and/ or Indian entities, which are ultimately owned and controlled by resident Indian citizens;
- (f) "company controlled by persons resident outside India" shall mean an Indian company that is controlled by persons resident outside India and "LLP controlled by persons resident outside India" shall mean an LLP that is controlled by persons resident outside India;
- (g) "downstream investment" shall mean investment made by an Indian entity which has total foreign investment in it, or an Investment Vehicle in the capital instruments or the capital, as the case may be, of another Indian entity;

- (h) "holding company" shall have the same meaning as assigned to it under Companies Act, 2013;
  - (i) "indirect foreign investment" means downstream investment received by an Indian entity from,-
    - (a) another Indian entity (IE) which has received foreign investment and (i) the IE is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India; or
    - (b) an investment vehicle whose sponsor or manager or investment manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India :
- Provided that no person resident in India other than an Indian entity can receive Indirect Foreign Investment;
- (j) "total foreign investment" means the total of foreign investment and indirect foreign investment and the same will be reckoned on a fully diluted basis;
  - (k) "strategic downstream investment" means investment by banking companies incorporated in India in their subsidiaries, joint ventures and associates.{Rule 23 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019}

## ACQUISITION AND TRANSFER OF IMMOVABLE PROPERTY IN INDIA

### Acquisition and transfer of property in India by a NRI or an OCI

- Rule 24 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a NRI or an OCI may -
- (a) (Acquire immovable property in India other than an agricultural land or farm house or plantation property: Provided that the consideration, if any, for transfer, shall be made out of:
    - (i) funds received in India through banking channels by way of inward remittance from any place outside India ; or
    - (ii) funds held in any non-resident account maintained in accordance with the provisions of the Act, rules or regulations framed thereunder:
- Provided further that no payment for any transfer of immovable property shall be made either by traveller's cheque or by foreign currency notes or by any other mode other than those specifically permitted under this clause;
- (b) Acquire any immovable property in India other than agricultural land or farm house or plantation property by way of gift from a person resident in India or from an NRI or from an OCI, who in any case is a relative as defined in clause (77) of section 2 of the Companies Act, 2013;
  - (c) Acquire any immovable property in India by way of inheritance from a person resident outside India who had acquired such property:-
    - (i) in accordance with the provisions of the foreign exchange law in force at the time of acquisition by him or the provisions of these rules ;or
    - (ii) from a person resident in India;
  - (d) transfer any immovable property in India to a person resident in India;
  - (e) transfer any immovable property other than agricultural land or farm house or plantation property to an NRI or an OCI.

### Joint acquisition by the spouse of a NRI or an OCI

Rule 25 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019 states that a person resident outside India, not being an NRI or an OCI, who is a spouse of an NRI or an OCI may acquire one immovable property (other than agricultural land or farm house or plantation property), jointly with his or her NRI or OCI spouse.

Provided that -

- (a) consideration for transfer, shall be made out of -
  - (i) funds received in India through banking channels by way of inward remittance from any place outside India; or
  - (ii) funds held in any non-resident account maintained in accordance with the provisions of the Act and the regulations made by the Reserve Bank;
- (b) no payment for any transfer of immovable property shall be made either by traveller's cheque or by foreign currency notes or by any other mode other than those specifically permitted .

Provided that the marriage has been registered and subsisted for a continuous period of not less than two years immediately preceding the acquisition of such property.

Provided further that the non-resident spouse is not otherwise prohibited from such acquisition.

### **Acquisition of immovable property for carrying on a permitted activity**

According to Rule 26 of Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person resident outside India who has established in India in accordance with the Foreign Exchange Management (Establishment in India of a Branch office or a liaison office or a project office or any other place of business) Regulations, 2016, as amended from time to time, a branch, office or other place of business for carrying on in India any activity, excluding a liaison office, may -

- (a) acquire any immovable property in India, which is necessary for or incidental to carrying on such activity.
- Provided that,-
- (i) all applicable laws, rules, regulations, for the time being in force are duly complied with; and
  - (ii) the person files with the Reserve Bank a declaration in the Form IPI as specified by the Reserve Bank from time to time, not later than ninety days from the date of such acquisition;
- (b) transfer by way of mortgage to an authorised dealer as a security for any borrowing, the immovable property acquired in pursuance of clause (a) stated above.

Provided that no person of Pakistan or Bangladesh or Sri Lanka or Afghanistan or China or Iran or Hong Kong or Macau or Nepal or Bhutan or Democratic People's Republic of Korea (DPRK) shall acquire immovable property, other than on lease not exceeding five years, without prior approval of the Reserve Bank.

### **Purchase or sale of immovable property by Foreign Embassies or Diplomats or Consulate Generals**

Rule 27 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019 provides that a Foreign Embassy or Diplomat or Consulate General may purchase or sell immovable property in India other than agricultural land or plantation property or farm house provided:

- (i) Clearance from Government of India, Ministry of External Affairs is obtained for such purchase or sale; and
- (ii) the consideration for acquisition of immovable property in India is paid out of funds remitted from abroad through banking channels.

### **Acquisition by a long-term visa holder**

As per Rule 28 of the Foreign Exchange Management (Non-debt Instruments) Rules, 2019, a person being a citizen of Afghanistan, Bangladesh or Pakistan belonging to minority communities in those countries, namely, Hindus, Sikhs, Buddhists, Jains, Parsis and Christians who is residing in India and has been granted a Long Term Visa (LTV) by the Central Government may purchase only one residential immovable property in India as dwelling unit for self-occupation and only one immovable property for carrying out self-employment subject to the following conditions, namely :-

- (a) the property shall not be located in and around restricted or protected areas so notified by the Central Government and cantonment areas;
- (b) the person submits a declaration to the Revenue Authority of the district where the property is located, specifying the source of funds and that he or she is residing in India on LTV;

- (c) the registration documents of the property shall mention the nationality and the fact that such person is on LTV;
- (d) the property of such person may be attached or confiscated in the event of his or her indulgence in anti- India activities;
- (e) a copy of the documents of the purchased property shall be submitted to the Deputy Commissioner of Police (DCP) or Foreigners Registration Office (FRO) or Foreigners Regional Registration Office (FRRO) concerned and to the Ministry of Home Affairs (Foreigners Division);
- (f) such person shall be eligible to sell the property only after acquiring Indian citizenship, however, transfer of the property before acquiring Indian citizenship shall require prior approval of DCP or FRO or FRRO concerned.

### Repatriation of sale proceeds

- (1) A person resident outside India or his successor shall not, except with the general or specific permission of the Reserve Bank, repatriate outside India the sale proceeds of any immovable property.
- (2) In the event of sale of immovable property other than agricultural land or farm house or plantation property in India by an NRI or an OCI, the authorised dealer may allow repatriation of the sale proceeds outside India, provided the following conditions are satisfied, namely:-
  - (a) the immovable property was acquired by the seller in accordance with the provisions of the foreign exchange law in force at the time of acquisition or the provisions of the Foreign Exchange Management (No debt Instrument) Rules, 2019
  - (b) the amount for acquisition of the immovable property was paid in foreign exchange received through banking channels or out of funds held in Foreign Currency Non-Resident Account or out of funds held in Non-Resident External Account;
  - (c) in the case of residential property, the repatriation of sale proceeds is restricted to not more than two such properties.
- (3) In the event of failure in repayment of external commercial borrowing availed by a person resident in India under the provisions of the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000, as amended from time to time, a bank which is an authorised dealer may permit the overseas lender or the security trustee (in whose favour the charge on immovable property has been created to secure the ECB) to sell the immovable property on which the said loan has been secured only to a (by the) person resident in India and to repatriate the sale proceeds towards outstanding dues in respect of the said loan and not any other loan.[Rule 29]

### Prohibition on transfer of immovable property in India

- (1) Save as otherwise provided in the FEMA or rules, no person resident outside India shall transfer any immovable property in India.
- Provided that:-
- (a) the Reserve Bank may, for sufficient reasons, permit the transfer subject to such conditions as may be considered necessary;
  - (b) a bank which is an authorised dealer may, subject to the directions issued by the Reserve Bank in this behalf, permit a person resident in India or on behalf of such person to create charge on his immovable property in India in favour of an overseas lender or security trustee, to secure an external commercial borrowing availed under the provisions of the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000;
  - (c) an authorised dealer in India being the Indian correspondent of an overseas lender may, subject to the directions issued by the Reserve Bank in this regard, create a mortgage on an immovable property in India owned by an NRI or an OCI, being a director of a company outside India, for a loan to be availed by the company from the said overseas lender;

Provided further that:-

- (i) the funds shall be used by the borrowing company only for its core business purposes overseas;
  - (ii) in case of invocation of charge, the Indian bank shall sell the immovable property to an eligible acquirer and remit the sale proceeds to the overseas lender.
- (2) A person resident outside India who has acquired any immovable property in India in accordance with foreign exchange laws in force at the time of such acquisition or with the general or specific permission of the Reserve Bank may transfer such property to a person resident in India provided the transaction takes place through banking channels in India and provided further that the resident is not otherwise prohibited from such acquisition. [Rule 30]

### **Prohibition on acquisition or transfer of immovable property in India by citizens of certain countries**

No person being a citizen of Pakistan, Bangladesh, Sri Lanka, Afghanistan, China, Iran, Nepal, Bhutan, Hong Kong or Macau or Democratic People's Republic of Korea (DPRK) without prior permission of the Reserve Bank shall acquire or transfer immovable property in India, other than lease not exceeding five years:

Provided that this prohibition shall not apply to an OCI.

Explanation: For the purpose of this rule, the term "citizen" shall include natural persons and legal entities. [Rule 31]

### **Miscellaneous**

Any transaction involving acquisition or transfer of immovable property under these rules shall be undertaken:-

- (a) through banking channels in India;
- (b) subject to payment of applicable taxes and other duties or levies in India. [Rule 32]

### **Savings**

Any existing holding of immovable property in India by a person resident outside India made in accordance with the policy in existence at the time of such acquisition would not require any modifications to conform to these rules. [Rule 33]

## **FOREIGN EXCHANGE MANAGEMENT (MODE OF PAYMENT AND REPORTING OF NON- DEBT INSTRUMENTS) REGULATIONS, 2019**

### **INTRODUCTION**

In exercise of the powers conferred by section 47 of the Foreign Exchange Management Act, 1999 and consequent to the Foreign Exchange Management (Non-Debt Instrument) Rules, 2019, the Reserve Bank of India issued the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 relating to mode of payment and reporting requirements for investment in India by a person resident outside India.

### **MODE OF PAYMENT AND REMITTANCE OF SALE PROCEEDS**

#### **Purchase or Sale of Equity Instruments of an Indian Company by a Person Resident outside India**

##### ***Mode of payment:***

- (1) The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in NRE/FCNR(B)/Escrow account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

Explanation: The amount of consideration shall include:

- (i) Issue of equity shares by an Indian company against any funds payable by it to the investor
- (ii) Swap of equity instruments.

- (2) Equity instruments shall be issued to the person resident outside India making such investment within sixty days from the date of receipt of the consideration.  
Explanation: In case of partly paid equity shares, the period of 60 days shall be reckoned from the date of receipt of each call payment
- (3) Where such equity instruments are not issued within sixty days from the date of receipt of the consideration the same shall be refunded to the person concerned by outward remittance through banking channels or by credit to his NRE/ FCNR (B) accounts, as the case may be within fifteen days from the date of completion of sixty days.
- (4) An Indian company issuing equity instruments under this Schedule may open a foreign currency account with an Authorised Dealer in India in accordance with Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2016.

***Remittance of sale proceeds***

The sale proceeds (net of taxes) of the equity instruments may be remitted outside India or may be credited to the NRE/ FCNR (B) of the person concerned.

**Investments by Foreign Portfolio Investors**

***Mode of payment:***

- (1) The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or a Special Non-Resident Rupee (SNRR) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.  
Provided balances in SNRR account shall not be used for making investment in units of Investment Vehicles other than the units of domestic mutual fund.
- (2) The foreign currency account and SNRR account shall be used only and exclusively for transactions under this Schedule.

***Remittance of sale proceeds:***

The sale proceeds (net of taxes) of equity instruments and units of domestic mutual fund may be remitted outside India or credited to the foreign currency account or a SNRR account of the FPI.

The sale proceeds (net of taxes) of units of investment vehicles other than domestic mutual fund may be remitted outside India.

***Mode of payment:***

- (1) The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a Non-Resident External (NRE) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
- (2) The NRE account will be designated as an NRE (PIS) Account and the designated account shall be used exclusively for putting through transactions permitted under this Schedule.
- (3) Investment in units of domestic mutual fund shall be paid as inward remittance from abroad through banking channels or out of funds held in NRE/FCNR(B) account.
- (4) Subscription to National Pension System shall be paid as inward remittance from abroad through banking channels or out of funds held in NRE/FCNR(B)/NRO account.

***Remittance of sale proceeds:***

The sale proceeds (net of taxes) of equity instruments may be remitted outside India or may be credited to NRE (PIS) account of the person concerned.

The sale proceeds (net of taxes) of units of mutual funds and subscription to National Pension System may be remitted outside India or may be credited to NRE (PIS)/FCNR(B)/NRO account of the person concerned at the option of the NRI/OCI investor.

## **Purchase or sale of equity instruments of an Indian company or units or contribution to the capital of a LLP by Non-Resident Indian (NRI) or Overseas Citizen of India (OCI) on Non-repatriation basis.**

### ***Mode of Payment:***

The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in NRE/FCNR(B)/NRO account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

### ***Sale/maturity proceeds:***

- (1) The sale/maturity proceeds (net of applicable taxes) of equity instruments or units or disinvestment proceeds of a LLP shall be credited only to the NRO account of the investor, irrespective of the type of account from which the consideration was paid;
- (2) The amount invested in equity instruments of an Indian company or the consideration for contribution to the capital of a LLP and the capital appreciation thereon shall not be allowed to be repatriated abroad.

## **Investment in a firm or a proprietary concern**

### ***Mode of payment:***

The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in NRE/FCNR(B)/NRO account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

### ***Sale/maturity proceeds:***

- (1) The disinvestment proceeds shall be credited only to the NRO account of the person concerned, irrespective of the type of account from which the consideration was paid;
- (2) The amount invested for contribution to the capital of a firm or a proprietary concern and the capital appreciation thereon shall not be allowed to be repatriated abroad.

## **Investment by other non-resident investors**

### ***Mode of Payment:***

The amount of consideration shall be paid out of inward remittances from abroad through banking channels.

### ***Remittance/credit of sale/ maturity proceeds:***

The sale/ maturity proceeds (net of taxes) may be remitted abroad.

## **Investment in a Limited Liability Partnership**

### ***Mode of payment:***

Payment by an investor towards capital contribution of an LLP shall be made by way of an inward remittance through banking channels or out of funds held in NRE or FCNR (B) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

### ***Remittance of disinvestment proceeds:***

The disinvestment proceeds may be remitted outside India or may be credited to NRE or FCNR (B) account of the person concerned.

## **Investment by a Foreign Venture Capital Investor**

### ***Mode of payment:***

- (1) The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/or a Special Non-Resident Rupee (SNRR) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

- (2) The foreign currency account and SNRR account shall be used only and exclusively for transactions under this Schedule.

**Remittance of sale/maturity proceeds:**

The sale/maturity proceeds (net of taxes) of the securities may be remitted outside India or may be credited to the foreign currency account or a Special Non-resident Rupee Account of the FVCI.

**Investment by a person resident outside India in an Investment Vehicle**

**Mode of payment:**

- (1) The amount of consideration shall be paid as inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/or a Special Non-Resident Rupee (SNRR) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
- (2) The foreign currency account and SNRR account shall be used only and exclusively for transactions under this Schedule.

**Remittance of sale/maturity proceeds:**

The sale/maturity proceeds (net of taxes) of the securities may be remitted outside India or may be credited to the foreign currency account or a Special Non-resident Rupee Account of the FVCI.

**Issue of Indian Depository Receipts**

**Mode of Payment:**

NRIs or OCIs may invest in the IDRs out of funds held in their NRE/FCNR (B) account, maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

**Remittance of sale/maturity proceeds:**

Redemption/conversion of IDRs into underlying equity shares of the issuing company shall be a compliance the Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004.

**Issue of Convertible Notes by an Indian start-up company:**

A start-up company issuing convertible notes to a person resident outside India shall receive the amount of consideration by inward remittance through banking channels or by debit to the NRE/FCNR(B)/Escrow account maintained by the person concerned in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

Repayment or sale proceeds may be remitted outside India or credited to NRE/FCNR(B) account maintained by the person concerned in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

**REPORTING REQUIREMENTS**

**The reporting requirement for any Investment in India by a person resident outside India shall be as follows:**

- (1) **Form Foreign Currency-Gross Provisional Return (FC-GPR):** An Indian Company issuing equity instruments to a person resident outside India and where such issue is reckoned as Foreign Direct Investment, defined under the rules, shall report such issue in Form FC-GPR, not later than thirty days from the date of issue of equity instruments. Issue of 'participating interest/rights' in oil fields shall be reported in Form FC-GPR.
- (2) **Annual Return on Foreign Liabilities and Assets (FLA):** An Indian Company which has received FDI or an LLP which has received investment by way of capital contribution in the previous year including the current year, shall submit form FLA to the Reserve Bank on or before the 15th day of July of each year.

**Explanation:** Year for this purpose shall be reckoned as April to March.

**(3) Form Foreign Currency-Transfer of Shares (FC-TRS):**

- (a) Form FCTRS shall be filed for transfer of equity instruments in accordance with the rules, between:
  - (i) a person resident outside India holding equity instruments in an Indian company on a repatriable basis and person resident outside India holding equity instruments on a non-repatriable basis; and
  - (ii) a person resident outside India holding equity instruments in an Indian company on a repatriable basis and a person resident in India,

The onus of reporting shall be on the resident transferor/transferee or the person resident outside India holding equity instruments on a non-repatriable basis, as the case may be.

**Note:** Transfer of equity instruments in accordance with the rules by way of sale between a person resident outside India holding equity instruments on a non-repatriable basis and person resident in India is not required to be reported in Form FC-TRS.

- (b) Transfer of equity instruments on a recognised stock exchange by a person resident outside India shall be reported by such person in Form FC-TRS.
- (c) Transfer of equity instruments prescribed in Rule 9(6) of the Rules, shall be reported in Form FC-TRS on receipt of every tranche of payment. The onus of reporting shall be on the resident transferor/transferee.
- (d) Transfer of 'participating interest/rights' in oil fields shall be reported Form FC-TRS.

The form FCTRS shall be filed within sixty days of transfer of equity instruments or receipt/remittance of funds whichever is earlier.

**(4) Form Employees' Stock Option (ESOP):** An Indian company issuing employees' stock option to persons resident outside India who are its employees/directors or employees/directors of its holding company/joint venture / wholly owned overseas subsidiary/subsidiaries shall file Form-ESOP, within 30 days from the date of issue of employees' stock option.

**(5) Form Depository Receipt Return (DRR):** The Domestic Custodian shall report in Form DRR, the issue / transfer of depository receipts issued in accordance with the Depository Receipt Scheme, 2014 within 30 days of close of the issue.

**(6) Form LLP (I):** A Limited Liability Partnerships (LLP) receiving amount of consideration for capital contribution and acquisition of profit shares shall file Form LLP (I), within 30 days from the date of receipt of the amount of consideration.

**(7) Form LLP (II):** The disinvestment/transfer of capital contribution or profit share between a resident and a non-resident (or vice versa) shall be filed in Form LLP(II) within 60 days from the date of receipt of funds. The onus of reporting shall be on the resident transferor/transferee.

**(8) LEC(FII):** The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (FII) the purchase/transfer of equity instruments by FPIs on the stock exchanges in India.

**(9) LEC(NRI):** The Authorised Dealer Category I banks shall report to the Reserve Bank in Form LEC (NRI) the purchase/transfer of equity instruments by Non-Resident Indians or Overseas Citizens of India on stock exchanges in India.

**(10) Form InVI:** An Investment vehicle which has issued its units to a person resident outside India shall file Form InVI within 30 days from the date of issue of units.

**(11) Downstream Investment**

- (a) An Indian entity or an investment vehicle making downstream investment in another Indian entity which is considered as indirect foreign investment for the investee Indian entity in terms of the Rules, shall notify the Secretariat for Industrial Assistance, DPIIT within 30 days of such investment, even if equity instruments have not been allotted, along with the modality of investment in new/existing ventures (with/without expansion programme).

- (b) Form DI: An Indian entity or an investment Vehicle making downstream investment in another Indian entity which is considered as indirect foreign investment for the investee Indian entity in terms of Rule 22 of the Rules shall file Form DI with the Reserve Bank within 30 days from the date of allotment of equity instruments.

**(12) Form Convertible Notes (CN):**

- (a) The Indian Start-up Company issuing Convertible Notes to a person resident outside India shall file Form CN within 30 days of such issue.
- (b) A person resident in India, who may be a transferor or transferee of Convertible Notes issued by an Indian start-up company shall report such transfers to or from a person resident outside India, as the case may be, in Form CN within 30 days of such transfer.

Provided, the format, periodicity and manner of submission of such reporting shall be as prescribed by Reserve Bank in this regard.

Provided further that unless otherwise specifically stated in Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019 all reporting shall be made through or by an Authorised Dealer bank, as the case may be.

**Delays in reporting**

The person/entity responsible for filing the reports shall be liable for payment of late submission fee, as may be decided by the Reserve Bank, in consultation with the Central Government, for any delays in reporting.

**FOREIGN EXCHANGE MANAGEMENT (DEBT INSTRUMENTS) REGULATIONS, 2019**

**INTRODUCTION**

In exercise of the powers conferred by section 6(2) (a) and section 47 of the Foreign Exchange Management Act, 1999, and in supersession of the Foreign Exchange Management (Transfer of Issue of Security by a Person Resident outside India) Regulations, 2017, the Reserve Bank of India issued the Foreign Exchange Management (Debt Instruments) Regulations, 2019 to regulate investment in India by a Person Resident Outside India.

**RESTRICTION ON INVESTMENT BY A PERSON RESIDENT OUTSIDE INDIA**

Regulations 3 of the Foreign Exchange Management (Debt Instruments) Regulations, 2019 states that save as otherwise provided in the Foreign Exchange Management Act, or rules or regulations made thereunder, no person resident outside India shall make any investment in India.

It may be noted that here investment means to subscribe, acquire, hold or transfer any debt instrument or unit issued by a person resident in India.

Provided that an investment made in accordance with the Foreign Exchange Management Act or the rules or the regulations framed thereunder and held on the date of commencement of Foreign Exchange Management (Debt Instruments) Regulations, 2019, shall be deemed to have been made under the Regulations and shall accordingly be governed by the Regulations.

Provided further that the Reserve Bank may, on an application made to it and for sufficient reasons, permit a person resident outside India to make any investment in India subject to such conditions as may be considered necessary.

**RESTRICTION ON RECEIVING INVESTMENT**

Regulations 4 of the Foreign Exchange Management (Debt Instruments) Regulations, 2019 provides that save as otherwise provided in the Foreign Exchange Management Act or rules or regulations made thereunder, an Indian entity or a mutual fund, or a venture capital fund or a firm or an association of persons or a proprietary concern shall not receive any investment in India from a person resident outside India or record such investment in its books.

Provided that the Reserve Bank may, on an application made to it and for sufficient reasons, permit an Indian entity or a mutual fund, or a venture capital fund or a Firm or an Association of Persons or a proprietary concern to receive any investment in India from a person resident outside India or to record such investment subject to such conditions as may be considered necessary.

### PERMISSION FOR MAKING INVESTMENT BY A PERSON RESIDENT OUTSIDE INDIA

Unless otherwise specified in Foreign Exchange Management (Debt Instruments) Regulations, 2019 or the relevant Schedules, any investment made by a person resident outside India shall be subject to the entry routes, the investment limits and the attendant conditionalities for such investment as laid down.

A person resident outside India, permitted for the purpose by the Reserve Bank in consultation with Central Government, may purchase or sell debt instruments in the manner and subject to the terms and conditions specified in Schedule 1 of Foreign Exchange Management (Debt Instruments) Regulations, 2019.

A person resident outside India may trade in all exchange traded derivative contracts approved by Securities and Exchange Board of India from time to time subject to the limits prescribed by Securities and Exchange Board of India and conditions specified in Schedule 1 of Foreign Exchange Management (Debt Instruments) Regulations, 2019.

A person resident outside India may enter into contract in any derivative transaction subject to conditions laid down by the Reserve Bank from time to time.

### PURCHASE AND SALE OF DEBT INSTRUMENTS BY A PERSON RESIDENT OUTSIDE INDIA

#### Permission to person's resident outside India

##### (A) *Permission to Foreign Portfolio Investors (FPIs)*

An FPI may purchase the following debt instruments on repatriation basis subject to the terms and conditions specified by the Securities and Exchange Board of India and the Reserve Bank:

- (a) dated Government securities/ treasury bills;
  - (b) non-convertible debentures/ bonds issued by an Indian company;
  - (c) commercial papers issued by an Indian company;
  - (d) units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity;
  - (e) Security Receipts (SRs) issued by Asset Reconstruction Companies;
  - (f) debt instruments issued by banks, eligible for inclusion in regulatory capital;
  - (g) Credit enhanced bonds;
  - (h) Listed non-convertible/ redeemable preference shares or debentures issued in terms of Regulation 6 of these Regulations;
  - (i) Securitised debt instruments, including (i) any certificate or instrument issued by a special purpose vehicle (SPV) set up for securitisation of asset/s with banks, Financial Institutions or NBFCs as originators;
  - (j) Rupee denominated bonds/ units issued by Infrastructure Debt Funds;
- Provided this will include such instruments issued on or after November 22, 2011 and held by deemed FPIs.
- (k) Municipal Bonds:

Provided that FPIs may offer such instruments as permitted by the Reserve Bank from time to time as collateral to the recognized Stock Exchanges in India for their transactions in exchange traded derivative contracts as specified in sub -Regulation 2 of Regulation 5.

**(B) Permission to Non-resident Indians (NRIs) or Overseas Citizens of India (OCIs) – Repatriation basis**

- (1) A Non-resident Indian (NRI) or an Overseas Citizen of India (OCI) may, without limit, purchase the following instruments on repatriation basis,
  - (a) Government dated securities (other than bearer securities) or treasury bills or units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity;
  - (b) Bonds issued by a Public Sector Undertaking (PSU) in India;
  - (c) Bonds issued by Infrastructure Debt Funds;
  - (d) Listed non-convertible/ redeemable preference shares or debentures issued in terms of Regulation 6 of these Regulations;
- (2) An NRI or an OCI may purchase on repatriation basis debt instruments issued by banks, eligible for inclusion in regulatory capital.
- (3) An NRI may subscribe to National Pension System governed and administered by Pension Fund Regulatory and Development Authority (PFRDA), provided such person is eligible to invest as per the provisions of the PFRDA Act. The annuity/ accumulated saving will be repatriable:

Provided that NRI/ OCIs may offer such instruments as permitted by the Reserve Bank from time to time as collateral to the recognized Stock Exchanges in India for their transactions in exchange traded derivative contracts as specified in subregulation 2 of regulation 5.

**(C) Permission to Non-resident Indians (NRIs) or Overseas Citizens of India (OCIs) – Non-Repatriation basis**

- (1) An NRI or an OCI may, without limit, purchase on non-repatriation basis, dated Government securities (other than bearer securities), treasury bills, units of domestic mutual funds or Exchange-Traded Funds (ETFs) which invest less than or equal to 50 percent in equity, or National Plan/ Savings Certificates.
- An NRI or an OCI may, without limit, purchase on non-repatriation basis, listed non-convertible/ redeemable preference shares or debentures issued in terms of Regulation 6 of these Regulations.
- (2) An NRI or an OCI may, without limit, on non-repatriation basis subscribe to the chit funds authorised by the Registrar of Chits or an officer authorised by the State Government in this behalf.

**(D) Permission to Foreign Central Banks or a Multilateral Development Bank for purchase of Government Securities**

- (1) Foreign Central Banks, Multilateral Development Banks or any other entity permitted by the Reserve Bank, may purchase or sell dated Government Securities/treasury bills, as per terms and conditions specified by the Reserve Bank.

**Mode of Payment**

- (1) The amount of consideration for purchase of instruments by FPIs shall be paid out of inward remittance from abroad through banking channels or out of funds held in a foreign currency account and/ or Special Non-Resident Rupee (SNRR) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016. The foreign currency account and SNRR account shall be used only and exclusively for transactions under this Schedule.
- (2) The amount of consideration for purchase of instruments by NRIs or OCIs on repatriation basis shall be paid out of inward remittances from abroad through banking channels or out of funds held in NRE/ FCNR (B) account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
- (3) The amount of consideration for (a) purchase of instruments by NRIs or OCIs on non-repatriation basis and (b) subscriptions to the National Pension System by NRIs shall be paid out of inward remittances from abroad through banking channels or out of funds held in NRE/ FCNR (B)/ NRO account maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.
- (4) The amount of consideration for purchase of Government dated securities by a Foreign Central Bank or a Multilateral Development Bank shall be paid out of inward remittances from abroad through banking channels or out of funds held in an account opened with the specific approval of the RBI.

- (5) The amount of consideration for purchase of instruments by other non-resident investors shall be paid out of inward remittances from abroad through banking channels.

### Permission for Sale of instruments

A person resident outside India who has purchased instruments in accordance with the Schedule of Foreign Exchange Management (Debt Instruments) Regulations, 2019 may sell/ redeem the instruments subject to such terms and conditions as may be specified by the Reserve Bank and the Securities Exchange Board of India.

### Remittance/ credit of sale/ maturity proceeds

- (1) The sale/ maturity proceeds (net of taxes) of instruments held by Foreign Portfolio Investors (FPIs) may be remitted outside India or may be credited to the foreign currency account or SNRR account of the FPI.
- (2) The net sale/ maturity proceeds (net of taxes) of instruments held by NRIs or OCIs, may be:
  - (a) Credited to the NRO account person concerned where the instruments were held on non-repatriation basis
  - (b) Credited to the NRO account person concerned where the payment for the purchase of the instruments sold was made out of funds held in NRO account, or
  - (c) Remitted abroad or at the NRI/ OCI investor's option, credited to his NRE/ FCNR (B)/ NRO account, where the instruments were purchased on repatriation basis.
- (3) In all other cases, the sale/ maturity proceeds (net of taxes) may be remitted abroad or credited to an account opened with the prior permission of the Reserve Bank.

### MERGER OR DEMERGER OR AMALGAMATION OF INDIAN COMPANIES

Regulation 6 of the Foreign Exchange Management (Debt Instruments) Regulations, 2019 provides that where a Scheme of Arrangement for an Indian company has been approved by National Company Law Tribunal (NCLT)/ Competent Authority, the Indian company may issue non-convertible redeemable preference shares or nonconvertible redeemable debentures out of its general reserves by way of distribution as bonus to the shareholders resident outside India, subject to the following conditions, namely:

- (a) the original investment made in the Indian company by a person resident outside India is in accordance with Foreign Exchange Management (Debt Instruments) Regulations, 2019 and the conditions specified in the relevant Schedule;
- (b) the said issue is in accordance with the provisions of the Companies Act, 2013 and the terms and conditions, if any, stipulated in the scheme approved by National Company Law Tribunal (NCLT)/ Competent Authority have been complied with;
- (c) the Indian company shall not engage in any activity/ sector in which investment by a person resident outside India is prohibited.

### TAXES AND REMITTANCE OF SALE PROCEEDS

#### Taxes

All transaction under the Foreign Exchange Management (Debt Instruments) Regulations, 2019 shall be undertaken through banking channels in India and subject to payment of applicable taxes and other duties/ levies in India.

#### Remittance of sale proceeds

- (1) No remittance of sale proceeds of a debt instrument held by a person resident outside India shall be made otherwise than in accordance with the Foreign Exchange Management (Debt Instruments) Regulations, 2019 and the conditions specified in the relevant Schedule.
- (2) An authorised dealer may allow the remittance of sale proceeds of a debt instrument (net of applicable taxes) to the seller of such instrument resident outside India -

Provided -

- (i) the instrument was held by the seller on repatriation basis; and
  - (ii) Reserve Bank's approval has been obtained in other cases for sale of the instrument and remittance of the sale proceeds thereof;
- (3) An authorised dealer may allow remittances – both inward and outward – related for permitted derivatives transactions.

### LESSON ROUND-UP

- "FDI" or "Foreign Direct Investment" means investment through equity instruments by a person resident outside India in an unlisted Indian company; or in ten per cent or more of the post issue paid- up equity capital on a fully diluted basis of a listed Indian company.
- A non-resident entity can invest in India, subject to the FDI Policy except in those sectors/activities which are prohibited. However, an entity of a country, which shares land border with India or where the beneficial owner of an investment into India is situated in or is a citizen of any such country, can invest only under the Government route.
- A citizen of Pakistan or an entity incorporated in Pakistan can invest, only under the Government route, in sectors/activities other than defence, space, atomic energy and sectors/activities prohibited for foreign investment.
- Indian companies can issue capital against Foreign Direct Investment.
- Indian companies which are eligible to issue shares to person's resident outside India under the FDI Policy may be allowed to retain the share subscription amount in a Foreign Currency Account, with the prior approval of RBI.
- FDI is permitted under the automatic route in Limited Liability Partnership (LLPs) operating in sectors/activities where 100% FDI is allowed through the automatic route and there are no FDI-linked performance conditions.
- FDI is allowed under the automatic route without prior approval either of the Government or the Reserve Bank of India in all activities/sectors as specified in the consolidated FDI Policy, issued by the Government of India from time to time.
- FDI in activities not covered under the automatic route requires prior approval of the Government. Proposals for foreign investment under Government route, are considered by respective Administrative Ministry/Department.
- If a person violates/contravenes any FDI Regulations, by way of breach/non-adherence/non- compliance/ contravention of any rule, regulation, notification, press note, press release, circular, direction or order issued in exercise of the powers under FEMA or contravenes any conditions subject to which an authorization is issued by the Government of India/ Reserve Bank of India, he shall, upon adjudication, be liable to a penalty.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define Foreign Direct Investment.
2. List out the sectors/activities where Foreign Direct Investment is permitted.
3. List out the sectors/activities where Foreign Direct Investment is prohibited.
4. Discuss conditions of Foreign Direct Investment in E-Commerce activities.
5. Write short notes on: (i) Automatic Route (ii) Government Route.

# Lesson 6 Overseas Direct Investments (ODI)

| <b><i>Key Concepts One Should Know</i></b>  | <b><i>Learning Objectives</i></b>   | <b><i>Regulatory Framework</i></b>  |
|---|---|---|
| <ul style="list-style-type: none"><li>• Indian Party</li><li>• Financial Commitment</li><li>• Joint Venture</li><li>• Wholly Owned Subsidiary</li><li>• Investment by Trust</li><li>• Investment by Societies</li></ul> | <p><b>To understand:</b></p> <ul style="list-style-type: none"><li>• Joint Ventures/Wholly Owned Subsidiaries Abroad</li><li>• Approval of Direct investment, i.e. Automatic Route and Approval Route</li><li>• Proposal for making ODI under approval route and Prior RBI approval</li><li>• Permissible Sources for Funding Overseas Direct Investment</li><li>• Acquisition/Sale of Foreign Securities by Resident Individual in India</li><li>• Obligations of Indian Party</li></ul> | <ul style="list-style-type: none"><li>• Foreign Exchange Management Act, 1999</li><li>• Foreign Exchange Management (Transfer or Issue of Any Foreign Security) Regulations, 2004</li></ul> |

## ***Lesson Outline***

- Introduction
- Approval Route
- Proposal for making Overseas Direct Investment
- Overseas Direct Investment transactions require prior approval
- Financial commitment
- Permissible source of funding
- Overseas investment by Trust
- Overseas investment by Societies
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

Overseas investments (or financial commitment) in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global reach of Indian entrepreneurs. Joint Ventures are perceived as a medium of economic and business co-operation between India and other countries. Transfer of technology and skill, sharing of results of R&D, access to wider global market, promotion of brand image, generation of employment and utilisation of raw materials available in India and in the host country are other significant benefits arising out of such overseas investments (or financial commitment). They are also important drivers of foreign trade through increased exports of plant and machinery and goods and services from India and also a source of foreign exchange earnings by way of dividend earnings, royalty, technical know-how fee and other entitlements on such investments (or financial commitment).

Foreign Exchange Management (Transfer or Issue of any Foreign Security) Regulations, 2004 regulate acquisition and transfer of a foreign security by a person resident in India i.e. investment (or financial commitment) by Indian entities in overseas joint ventures and wholly owned subsidiaries as also investment by a person resident in India in shares and securities issued outside India. Overseas Investment (or financial commitment) can be made under two routes viz. (i) Automatic Route and (ii) Approval Route.

“Financial Commitment” means the amount of direct investment by way of contribution to equity, loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an Indian Party to or on behalf of its overseas Joint Venture Company or Wholly Owned Subsidiary.

“Joint Venture (JV)” means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country in which the Indian Party makes a direct investment;

“Wholly Owned Subsidiary (WOS)” means a foreign entity formed, registered or incorporated in accordance with the laws and regulations of the host country, whose entire capital is held by the Indian Party;

## Investment in JV/WOS

An Indian Party has been permitted to make investment / undertake financial commitment in overseas Joint Ventures (JV) / Wholly Owned Subsidiaries (WOS), as per the ceiling prescribed by the Reserve Bank from time to time.

“Indian Party” means a company incorporated in India or a body created under an Act of Parliament or a partnership firm registered under the Indian Partnership Act, 1932, or a Limited Liability Partnership (LLP), registered under the Limited Liability Partnership Act, 2008, making investment in a Joint Venture or Wholly Owned Subsidiary abroad, and includes any other entity in India as may be notified by the Reserve Bank. When more than one such company, body or entity makes investment in the foreign JV / WOS, such combination will also form an “Indian Party”.

The total financial commitment of the Indian Party in all the Joint Ventures / Wholly Owned Subsidiaries shall comprise of the following:

- a. 100% of the amount of equity shares and/ or Compulsorily Convertible Preference Shares (CCPS);
- b. 100% of the amount of other preference shares;
- c. 100% of the amount of loan;
- d. 100% of the amount of guarantee (other than performance guarantee) issued by the Indian Party;
- e. 100% of the amount of bank guarantee issued by a resident bank on behalf of JV or WOS of the Indian Party provided the bank guarantee is backed by a counter guarantee / collateral by the Indian Party.
- f. 50% of the amount of performance guarantee issued by the Indian Party provided that if the outflow on account of invocation of performance guarantee results in the breach of the limit of the financial commitment in force, prior permission of the Reserve Bank is to be obtained before executing remittance beyond the limit prescribed for the financial commitment.

## Permissible Sources for Funding Overseas Direct Investment

Funding for Overseas Direct Investment can be made by one or more of the following sources:

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Draw of foreign exchange from an AD bank in India

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Swap of shares (refers to the acquisition of the shares of an overseas JV/WOS by way of exchange of the shares of the Indian party)

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Capitalization of export and other dues and entitlements

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Proceeds of External Commercial Borrowings/ Foreign Currency Convertible Bonds

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In exchange of ADRs/GDRs issued in accordance with the scheme for issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism) Scheme, 1993 and the guideline issued by Government of India in the matter.

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Balance held in Exchange Earners Foreign Currency account of the Indian Party maintained with an Authorized Dealer

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Proceeds of foreign currency funds raised through ADR/GDR issues

### Indian company making investment in a JV/WOS abroad in the financial services sector

Only an Indian company engaged in financial services sector activities can make investment in a JV/WOS abroad in the financial services sector, provided it fulfills the following additional conditions:

- i. has earned net profit during the preceding three financial years from the financial services activities;
- ii. is registered with the appropriate regulatory authority in India for conducting financial services activities;
- iii. has obtained approval for undertaking such activities from the concerned regulatory authorities both in India and abroad before venturing into such financial activity;
- iv. has fulfilled the prudential norms relating to capital adequacy as prescribed by the concerned regulatory authority in India;

## OVERSEAS INVESTMENTS BY PROPRIETORSHIP CONCERNS AND REGISTERED TRUST SOCIETY

### Proprietorship Concerns

The proposal for overseas direct investment (or financial commitment), by a proprietorship concern / unregistered partnership firm in India are to be considered by the Reserve Bank under the approval route are subject to following terms and conditions:

- (a) The proprietorship concern / unregistered partnership firm in India is classified as 'Status Holder' as per the Foreign Trade Policy issued by the Ministry of Commerce and Industry, Government of India from time to time;

- (b) The proprietorship concern / unregistered partnership firm in India has a proven track record, i.e., the export outstanding does not exceed 10% of the average export realisation of preceding three years and a consistently high export performance;
- (c) The Authorised Dealer bank is satisfied that the proprietorship concern / unregistered partnership firm in India is KYC (Know Your Customer) compliant, engaged in the proposed business and has turnover as indicated;
- (d) The proprietorship concern / unregistered partnership firm in India has not come under the adverse notice of any Government agency like the Directorate of Enforcement, Central Bureau of Investigation, Income Tax Department, etc. and does not appear in the exporters' caution list of the Reserve Bank or in the list of defaulters to the banking system in India; and
- (e) The amount of proposed investment (or financial commitment) outside India does not exceed 10 per cent of the average of last three years' export realisation or 200 per cent of the net owned funds of the proprietorship concern/ unregistered partnership firm in India, whichever is lower.

## Registered Trusts and Societies

Registered Trusts and Societies engaged in manufacturing/ educational/ hospital sector are allowed to make investment (or financial commitment) in the same sector(s) in a JV/WOS outside India, with the prior approval of the Reserve Bank.

### Eligibility Criteria for Trust

- (i) The Trust should be registered under the Indian Trust Act, 1882;
- (ii) The Trust deed permits the proposed investment overseas;
- (iii) The proposed investment should be approved by the trustee/s;
- (iv) The AD Category – I bank is satisfied that the Trust is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- (v) The Trust has been in existence at least for a period of three years;
- (vi) The Trust has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, Central Bureau of Investigation (CBI), etc.

### Eligibility Criteria for Society

- (i) The Society should be registered under the Societies Registration Act, 1860.
- (ii) The Memorandum of Association and rules and regulations permit the Society to make the proposed investment which should also be approved by the governing body/council or a managing / executive committee.
- (iii) The AD Category - I bank is satisfied that the Society is KYC (Know Your Customer) compliant and is engaged in a bonafide activity;
- (iv) The Society has been in existence at least for a period of three years;
- (v) The Society has not come under the adverse notice of any Regulatory / Enforcement agency like the Directorate of Enforcement, CBI etc.

In addition to registration, the AD Category – I bank should ensure that the special license / permission has been obtained by the applicant in case the activities require special license / permission either from the Ministry of Home Affairs, Government of India or from the relevant local authority, as the case may be.

An application in form ODI may be made to the Chief General Manager, Reserve Bank of India, Foreign Exchange Department, Overseas Investment Division, through the AD Category - I bank. AD Category - I banks may forward the application to the Reserve Bank, after ensuring the above terms and conditions along with their comments and recommendations, for consideration.

## Acquisition/Sale of Foreign Securities by Resident Individual in India

Resident individuals can acquire/sell foreign securities without prior approval in the following cases:—

- i. As a gift from a person resident outside India;
- ii. By way of ESOPs issued by a company incorporated outside India under Cashless Employees Stock Option Scheme which does not involve any remittance from India;
- iii. By way of ESOPs issued to an employee or a director of Indian office or branch of a foreign company or of a subsidiary in India of a foreign company or of an Indian company irrespective of the percentage of the direct or indirect equity stake in the Indian company;
- iv. As inheritance from a person whether resident in or outside India;
- v. By purchase of foreign securities out of funds held in the Resident Foreign Currency Account maintained in accordance with the Foreign Exchange Management (Foreign Currency Account) Regulations, 2000; and
- vi. By way of bonus/rights shares on the foreign securities already held by them.

## Resident individual acquiring shares of a foreign company in the capacity as Director

Reserve Bank has given general permission to a resident individual to acquire foreign securities to the extent of the minimum number of qualification shares required to be held for holding the post of Director.

Accordingly, resident individuals are permitted to remit funds under general permission for acquiring qualification shares for holding the post of a Director in the overseas company to the extent prescribed as per the law of the host country where the company is located and the limit of remittance for acquiring such qualification shares shall be within the overall ceiling prescribed for the resident individuals under the Liberalized Remittance Scheme (LRS) in force at the time of acquisition.

## Indian Mutual Funds for investment abroad

Indian Mutual Funds registered with SEBI are permitted to invest within the overall cap of USD 7 billion in:

- a. ADRs / GDRs of the Indian and foreign companies;
- b. Equity of overseas companies listed on recognized overseas stock exchanges; initial and follow on public offerings for listing at recognized overseas stock exchanges;
- c. Foreign debt securities- short term as well as long term with rating not below investment grade - in the countries with fully convertible currencies;
- d. Money market investments not below investment grade; repos where the counter party is not below investment grade;
- e. Government securities where countries are not rated below investment grade;
- f. Derivatives traded on recognized stock exchanges overseas only for hedging and portfolio balancing with underlying as securities;
- g. Short term deposits with banks overseas where the issuer is rated not below investment grade; and
- h. Units / securities issued by overseas Mutual Funds or Unit Trusts registered with overseas regulators.

## Obligations of Indian party which has made direct investment outside India

An Indian Party which has made direct investment outside India is required to comply with the following:—

- (i) Receive share certificates or any other documentary evidence of investment in the foreign JV / WOS as an evidence of investment and submit the same to the designated AD within 6 months;
- (ii) Repatriate to India, all dues receivable from the foreign JV / WOS, like dividend, royalty, technical fees etc.;
- (iii) Submit to the Reserve Bank through the designated Authorized Dealer, every year, an Annual Performance Report in Part II of Form ODI in respect of each JV or WOS outside India set up or acquired by the Indian party.

## LESSON ROUND-UP

- Overseas investments (or financial commitment) in Joint Ventures (JV) and Wholly Owned Subsidiaries (WOS) have been recognised as important avenues for promoting global business by Indian entrepreneurs.
- “Financial Commitment” means the amount of direct investment by way of contribution to equity, loan and 100 per cent of the amount of guarantees and 50 per cent of the performance guarantees issued by an Indian Party to or on behalf of its overseas Joint Venture Company or Wholly Owned Subsidiary.
- Indian party/ Resident Individual is required to route all transactions in respect of a particular overseas JV/WOS only through one branch of an Authorized Dealer. This branch would be the ‘designated Authorised Dealer’ in respect of that JV/WOS and all transactions and communications relating to the investment in that particular JV/WOS are to be reported only through this ‘designated’ branch of an Authorized Dealer.
- An Indian Party is a company incorporated in India or a body created under an Act of Parliament or
- a partnership firm registered under the Indian Partnership Act 1932 or a Limited Liability Partnership (LLP) incorporated under the LLP Act, 2008 and any other entity in India as may be notified by the
- Reserve Bank. When more than one such company, body or entity makes investment in the foreign JV / WOS, such combination will also form an “Indian Party”.
- An Indian Party receive share certificates or any other documentary evidence of investment in the foreign JV / WOS as an evidence of investment and submit the same to the designated AD within 6 months and repatriate to India, all dues receivable from the foreign JV / WOS, like dividend, royalty, technical fees etc.

## TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

- What is direct investment outside India?
- What is financial commitment under Overseas Direct Investment?
- State Permissible source of funding under Overseas Direct Investment.
- Discuss the eligibility criteria for overseas investment by Trust.
- Discuss the eligibility criteria for overseas investment by Society.

## Lesson 7

# Liberalized Remittance Scheme (LRS)

### ***Key Concepts One Should Know***

- Liberalized Remittance Scheme
- Prohibited Transactions

### ***Learning Objectives***

#### **To understand:**

- Overview of Liberalised Remittance Scheme
- Permissible Capital Account Transactions and Current Account Transactions by an individual under LRS
- Remittance Facilities to Persons other than Individuals

### ***Regulatory Framework***

- Foreign Exchange Management Act, 1999
- Foreign Exchange Management (Current Account Transactions) Rules, 2000

### ***Lesson Outline***

- Introduction
- Permissible Capital Account Transactions
- Permissible Current Account Transactions
- Documentation by the remitter
- Prohibited Transactions
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

The Reserve Bank of India as part of its liberalization measure to facilitate resident individuals to remit funds abroad for permitted current or capital account transactions or combination of both issues Liberalised Remittance Scheme.

The LRS limit has been revised in stages consistent with prevailing macro and micro economic conditions. During the period from February 4, 2004 till date, the LRS limit has been revised as under:

Liberalised Remittance Scheme permits the Authorised Dealers to freely allow remittances by resident individuals up to *USD 2,50,000 per Financial Year (April-March)* for any permitted current or capital account transaction or a combination of both. The Scheme is available to all resident individuals including minors. In case of remitter being a minor, the Form A2 must be countersigned by the minor's natural guardian. The Scheme is not available to corporates, partnership firms, HUF, Trusts etc.

| (Amount in USD)        |             |              |             |              |              |             |              |
|------------------------|-------------|--------------|-------------|--------------|--------------|-------------|--------------|
|                        | Feb 4, 2004 | Dec 20, 2006 | May 8, 2007 | Sep 26, 2007 | Aug 14, 2013 | Jun 3, 2014 | May 26, 2015 |
| <b>LRS limit (USD)</b> | 25,000      | 50,000       | 1,00,000    | 2,00,000     | 75,000       | 1,25,000    | 2,50,000     |

Remittances under the Scheme can be consolidated in respect of family members subject to individual family members complying with its terms and conditions. However, clubbing is not permitted by other family members for capital account transactions such as opening a bank account/investment/purchase of property, if they are not the co-owners/co-partners of the overseas bank account/ investment/property. Further, a resident cannot gift to another resident, in foreign currency, for the credit of the latter's foreign currency account held abroad under LRS.

All other transactions which are otherwise not permissible under FEMA and those in the nature of remittance for margins or margin calls to overseas exchanges/ overseas counterparty are not allowed under the Scheme.

## Permissible capital account transactions by an individual under LRS

The permissible capital account transactions by an individual under LRS are:

Opening of foreign currency account abroad with a bank

Purchase of property abroad

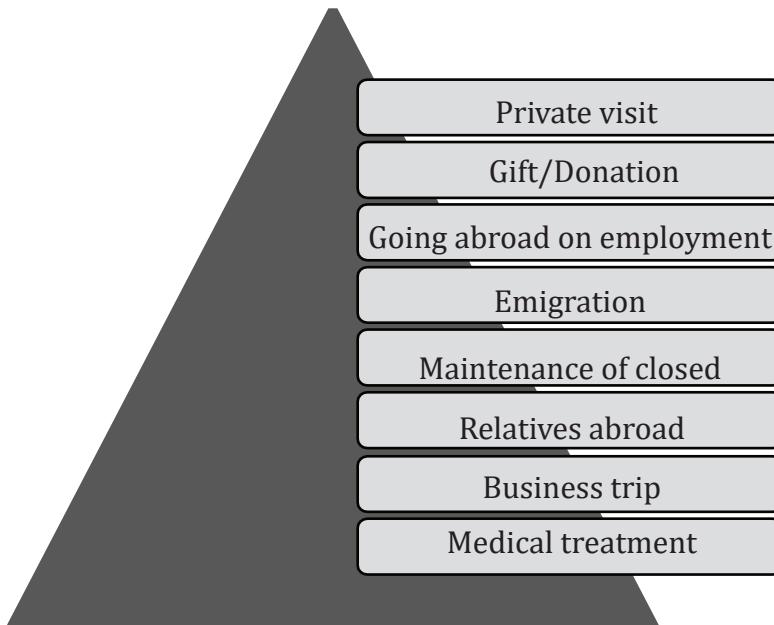
Making investments abroad- acquisition and holding shares of both listed and unlisted overseas company or debt instruments

Acquisition of qualification shares of an overseas company for holding the post of Director; acquisition of shares of a foreign company towards professional services rendered or in lieu of Director's remuneration

Investment in units of Mutual Funds, Venture Capital Funds, unrated debt securities, promissory notes

## Permissible Current Account Transactions by an individual under LRS

The limit of USD 2,50,000 per Financial Year (FY) under the Scheme also includes/subsumes remittances for current account transactions such as:



It may be noted that release of foreign exchange in excess of USD 2, 50,000, requires prior permission from the Reserve Bank of India.

### ***a. Private visits***

For private visits abroad, other than visit to Nepal and Bhutan, resident individual can obtain foreign exchange up to an aggregate amount of USD 2,50,000, from an Authorised Dealer, in any one financial year, irrespective of the number of visits undertaken during the year.

Further, all tour related expenses including cost of rail/road/water transportation; cost of Euro Rail; passes/ tickets, etc. outside India; and overseas hotel/lodging expenses are to be subsumed under the LRS limit. The tour operator can collect this amount either in Indian rupees or in foreign currency from the resident traveller.

### ***b. Gift/donation***

Any resident individual may remit up-to USD 2,50,000 in one Financial Year as gift to a person residing outside India or as donation to an organization outside India.

### ***c. Going abroad on employment***

A person going abroad for employment can draw foreign exchange up to USD 2,50,000 per Financial Year from any Authorised Dealer in India.

### ***d. Emigration***

A person wanting to emigrate can draw foreign exchange from AD Category I bank and AD Category II up to the amount prescribed by the country of emigration or USD 250,000. Remittance of any amount of foreign exchange outside India in excess of this limit may be allowed only towards meeting incidental expenses in the country of immigration and not for earning points or credits to become eligible for immigration by way of overseas investments in government bonds; land; commercial enterprise; etc.

### ***e. Maintenance of close relatives abroad***

A resident individual can remit up-to USD 2,50,000 per Financial Year towards maintenance of close relatives.

#### ***f. Business trip***

Visits by individuals in connection with attending of an international conference, seminar, specialised training, apprentice training, etc., are treated as business visits. For business trips to foreign countries, resident individuals can avail of foreign exchange up to USD 2,50,000 in a Financial Year irrespective of the number of visits undertaken during the year.

However, if an employee is being deputed by an entity for any of the above and the expenses are borne by the latter, such expenses are to be treated as residual current account transactions outside LRS and may be permitted by the AD without any limit, subject to verifying the bonafides of the transaction.

#### ***g. Medical treatment abroad***

Authorised Dealers may release foreign exchange up to an amount of USD 2,50,000 or its equivalent per Financial Year without insisting on any estimate from a hospital/doctor. For amount exceeding the above limit, Authorised Dealers may release foreign exchange under general permission based on the estimate from the doctor in India or hospital/ doctor abroad. A person who has fallen sick after proceeding abroad may also be released foreign exchange by an Authorised Dealer (without seeking prior approval of the Reserve Bank of India) for medical treatment outside India.

In addition to the above, an amount up to USD 250,000 per financial year is allowed to a person for accompanying as attendant to a patient going abroad for medical treatment/check-up.

#### ***h. Facilities available to students for pursuing their studies abroad***

AD Category I banks and AD Category II, may release foreign exchange up to USD 2,50,000 or its equivalent to resident individuals for studies abroad without insisting on any estimate from the foreign University. However, AD Category I bank and AD Category II may allow remittances (without seeking prior approval of the Reserve Bank of India) exceeding USD 2,50,000 based on the estimate received from the institution abroad.

#### **Documentation by the remitter**

The resident individual is required to compulsorily designate a branch of an AD through which all the remittances under the Scheme will be made. The resident individual seeking to make the remittance should furnish Form A2 for purchase of foreign exchange under LRS.

It is mandatory to have PAN card to make remittances under the Scheme for capital account transactions.

Investor, who has remitted funds under LRS can retain, reinvest the income earned on the investments. At present, the resident individual is not required to repatriate the funds or income generated out of investments made under the Scheme. However, a resident individual who has made overseas direct investment in the equity shares; compulsorily convertible preference shares of a JV/WoS outside India or ESOPs, within the LRS limit, is required to comply with the terms and conditions prescribed by the overseas investment guidelines under Foreign Exchange Management (Transfer or Issue of any Foreign Security) (Amendment) Regulations, 2013.

### **REMITTANCE FACILITIES TO PERSONS OTHER THAN INDIVIDUALS**

#### **Gift/donation**

General permission has been granted to persons other than individuals to remit towards donations up-to one per cent of their foreign exchange earnings during the previous three financial years or USD 5,000,000, whichever is less, for creation of Chairs in reputed educational institutes,

- (a) contribution to funds (not being an investment fund) promoted by educational institutes; and
- (b) contribution to a technical institution or body or association in the field of activity of the donor Company.
- (c) Any additional remittance in excess of the same shall require prior approval of the Reserve Bank of India.

**Procedure for remittance:**

Applications for remittances for purposes other than those specified above may be forwarded to the Reserve Bank of India together with

- (a) details of their foreign exchange earnings during the last 3 years,
- (b) brief background of the company's activities,
- (c) purpose of the donation.

**Commission to agents abroad for sale of residential flats or commercial plots in India**

Remittances by persons other than individuals is subject to prior approval of the Reserve Bank of India if commission per transaction to agents abroad for sale of residential flats or commercial plots in India exceeds USD 25,000 or five percent of the inward remittance whichever is more.

**Remittances towards consultancy services**

Remittances by persons other than individuals is subject to prior approval of the Reserve Bank of India, if remittance exceeds USD 10,000,000 per project for any consultancy services in respect of infrastructure projects and USD 1,000,000 per project, for other consultancy services procured from outside India.

**Remittances towards re-imbursement of pre-incorporation expenses**

Remittances by persons other than individuals are subject to prior approval of the Reserve Bank of India if remittance exceed five per cent of investment brought into India or USD 100,000 whichever is higher, by an entity in India by way of reimbursement of pre-incorporation expenses.

**Payment of fees in foreign currency - Embassy affiliated educational institutions**

Authorised Dealers may sell foreign exchange towards payment of fees to schools/educational institutions under the administrative control of foreign embassies.

**Remittance towards payments of collected subscription to overseas TV media company**

Authorised dealers may allow cable operators or collection agents in India of overseas TV media companies, to remit subscription collected from subscribers in India/advertisement charges collected from the advertisers who are eligible to advertise on overseas TV channels without any prior permission from the Reserve Bank.

**Bids in foreign currency for projects to be executed in India**

Persons resident in India are permitted to incur liability in foreign exchange and to make or to receive payments in foreign exchange, in respect of global bids where the Central Government has authorised such projects to be executed in India.

In such cases, authorised dealers may sell foreign exchange to the concerned resident Indian company which has been awarded the contract.

**Sale of overseas telephone cards**

Authorised Dealers may allow agents in India of the overseas organisations issuing pre-paid telephone cards to remit the sale proceeds of such cards, net of their commission, to the issuers of the telephone cards.

**Liberalization of foreign technical collaboration agreements**

AD Category-I banks may permit drawal of foreign exchange by persons for payment of royalty and lump-sum payment under technical collaboration agreements without the approval of Ministry of Commerce and Industry, Government of India.

## Drawal of foreign exchange for remittance for purchase of trademark or franchise in India

AD Category-I banks may permit drawal of foreign exchange by person for purchase of trademark or franchise in India without approval of the Reserve Bank.

### Remittances for making tour arrangements by agents

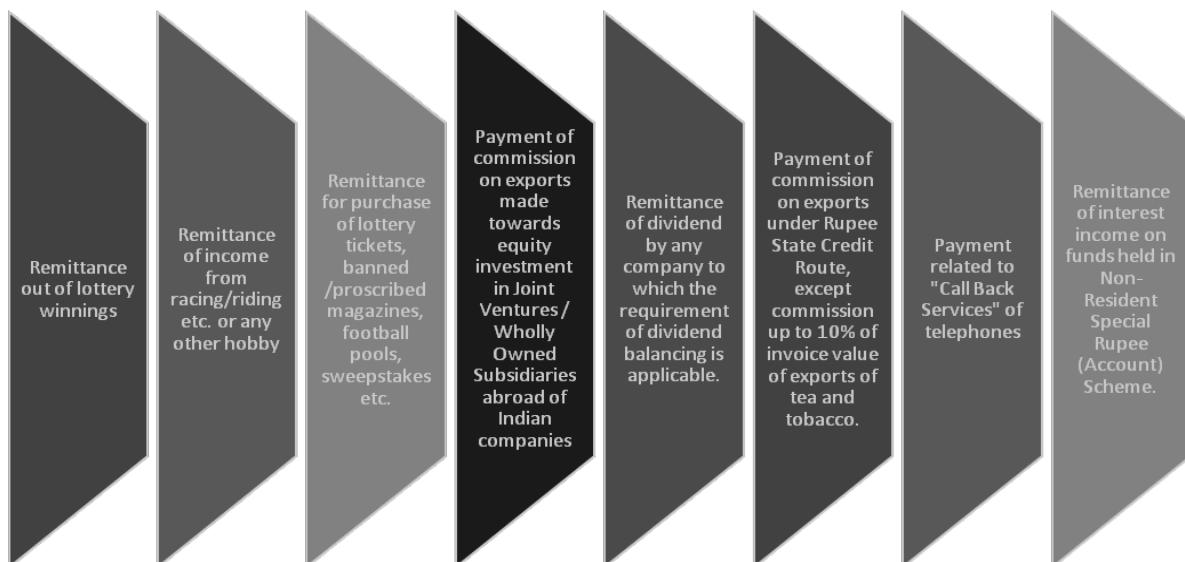
Authorised Dealers may effect remittances at the request of agents in India who have tie-up arrangements with hotels/ agents etc., abroad for providing hotel accommodation or making other tour arrangements for travel from India, provided the Authorised Dealer is satisfied that the remittance is being made out of the foreign exchange purchased by the traveller concerned from an Authorised Person (including exchange drawn for private travel abroad) in accordance with the Rules, Regulations and Direction in force.

- Authorised Dealer may open foreign currency accounts in the name of agents in India who have tie up arrangements with hotels/ agents, etc., abroad for providing hotel accommodation or making other tour arrangements for travellers from India provided:-
- (i) the credits to the account are by way of depositing:-
    - (a) collections made in foreign exchange from travellers; and
    - (b) refunds received from outside India on account of cancellation of bookings/ tour arrangements etc., and
  - (ii) the debits in foreign exchange are for making payments towards hotel accommodation, tour arrangements etc., outside India.

Authorised Dealer may also allow tour operators to remit the cost of rail/ road/ water/transportation charges outside India without any prior approval from Reserve Bank, net of commission/ mark up due to the agent. The sale of passes/ ticket in India can be made either against the payment in Indian Rupees or in foreign exchange released for visits abroad.

In respect of consolidated tours arranged by travel agents in India for foreign tourists visiting India and neighbouring countries like Nepal, Bangladesh, Sri Lanka etc., against advance payments/ reimbursement through an Authorised Dealer, part of the foreign exchange received in India against such consolidated tour arrangement, may require to be remitted from India to these neighbouring countries for services rendered by travel agents and hoteliers in these countries. Authorised Dealer may allow such remittances after verifying that the amount being remitted to the neighbouring countries (inclusive of remittances, if any, already made against the tour) does not exceed the amount actually remitted to India and the country of residence of the beneficiary is not Pakistan.

### Prohibited Transactions



**LESSON ROUND-UP**

- As liberalization measure to facilitate resident individuals to remit funds abroad for permitted current or capital account transactions or combination of both Reserve Bank of India issues Liberalised Remittance Scheme.
- The Scheme is available to all resident individuals including minors.
- Remittances under the Scheme can be consolidated in respect of family members subject to individual family members complying with its terms and conditions.
- For private visits abroad, other than to Nepal and Bhutan, any resident individual can obtain foreign exchange up to an aggregate amount of USD 2,50,000, from an Authorised Dealer in any one financial year, irrespective of the number of visits undertaken during the year.
- The individual will have to designate a branch of an AD through which all the remittances under the Scheme will be made. The resident individual seeking to make the remittance should furnish Form A2 for purchase of foreign exchange under LRS.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Enumerate the Prohibited Transactions under Liberalized Remittance Scheme.
2. Discuss remittance facilities to persons other than individuals under Liberalized Remittance Scheme.
3. State the Facilities available to students for pursuing their studies abroad under Liberalized Remittance Scheme.
4. Discuss the permissible Current Account Transactions by an individual under Liberalized Remittance Scheme.
5. Discuss the permissible capital account transactions by an individual under Liberalized Remittance Scheme.



## Lesson 8

# External Commercial Borrowings (ECB)

### ***Key Concepts One Should Know***

- External Commercial Borrowings (ECB)
- All-in-Cost
- ECB liability-Equity ratio
- Approval route
- Automatic route
- IOSCO Compliant Country

### ***Learning Objectives***

#### **To understand:**

- External Commercial Borrowings (ECB)
- Borrowing or Lending in Foreign Exchange
- Conversion of ECB into Equity
- Authorized Persons
- Security for raising ECB
- ECB facility for Startups

### ***Regulatory Framework***

- Foreign Exchange Management Act, 1999
- Foreign Exchange Management (Borrowing and Lending) Regulations, 2018
- Foreign Exchange Management (Guarantees) Regulations, 2000

### ***Lesson Outline***

- Introduction
- Available routes for raising ECB
- Minimum Average Maturity Period
- Eligible Borrowers
- Recognised Lenders/Investors
- End-use Prescriptions
- Conversion of ECB into equity
- Reporting Requirements
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

External Commercial Borrowings are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc. Transactions on account of External Commercial Borrowings (ECB) are governed by Section 6(3) (d) of the Foreign Exchange Management Act, 1999 (FEMA). Various provisions in respect of borrowings from overseas are included in the Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2018 and the Foreign Exchange Management (Guarantees) Regulations, 2000 as amended from time to time framed under FEMA. Within the contours of the Regulations, Reserve Bank of India also issues directions to Authorised Persons.

### ECB Framework

The framework for raising loans through ECB comprises the following two options:

| Parameters            | Foreign Currency denominated ECB  | Indian Rupee denominated ECB   |
|-----------------------|---|--|
| Currency of Borrowing | Any freely convertible Foreign Currency   | Indian Rupee (INR)   |
| Forms of ECB          | <p>Loans including bank loans; floating/ fixed rate notes/ bonds/ debentures (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; Foreign Currency Convertible Bonds; Foreign Currency Exchangeable Bonds and Financial Lease.</p> <p>It may be noted that Foreign Currency Convertible Bonds (FCCBs) refers to foreign currency denominated instruments which are issued in accordance with the Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depositary Receipt Mechanism) Scheme, 1993, as amended from time to time. Issuance of FCCBs shall also conform to other applicable regulations. Further, FCCBs should be without any warrants attached.</p> <p>Further, Foreign Currency Exchangeable Bonds (FCEBs) refers to foreign currency denominated instruments which are issued in accordance with the Issue of Foreign Currency Exchangeable Bonds Scheme, 2008, as amended from time to time. FCEBs are exchangeable into equity share of another company, to be called the Offered Company, in any manner, either wholly, or partly or on the basis of any equity related warrants attached to debt instruments. Issuance of FCEBs shall also conform to other applicable regulations.</p> | <p>Loans including bank loans; floating/ fixed rate notes/bonds/ debentures/ preference shares (other than fully and compulsorily convertible instruments); Trade credits beyond 3 years; and Financial Lease. Also, plain vanilla Rupee denominated bonds issued overseas, which can be either placed privately or listed on exchanges as per host country regulations.</p> |
| Eligible Borrowers    | <p>All entities eligible to receive Foreign Direct Investment (FDI). Further, the following entities are also eligible to raise ECB:</p> <ol style="list-style-type: none"> <li>Port Trusts;</li> <li>Units in SEZ;</li> <li>SIDBI; and</li> <li>EXIM Bank of India.</li> </ol>   | <p>(a) All entities eligible to raise Foreign Currency ECB; and</p> <p>(b) Registered entities engaged in micro-finance activities, viz., registered Not for Profit companies, registered societies/trusts/ cooperatives and Non-Government Organisations.</p>   |

## Recognised Lenders

The lender should be resident of Financial Action Task Force (FATF) or International Organisation of Securities Commission's IOSCO compliant country, including on transfer of ECB. However,

- (a) Multilateral and Regional Financial Institutions where India is a member country will also be considered as recognised lenders;
- (b) Individuals as lenders can only be permitted if they are foreign equity holders or for subscription to bonds/debentures listed abroad; and
- (c) Foreign branches / subsidiaries of Indian banks are permitted as recognised lenders only for Foreign Currency ECB (except FCCBs and FCEBs). Foreign branches / subsidiaries of Indian banks, subject to applicable prudential norms, can participate as arrangers/underwriters/market-makers/traders for Rupee denominated Bonds issued overseas. However, underwriting by foreign branches/subsidiaries of Indian banks for issuances by Indian banks will not be allowed.

It may be noted that FATF Compliant Country means a country that is a member of the Financial Action Task Force (FATF) or a member of a FATF-Style Regional Body; and should not be a country identified in the public statement of the FATF as (i) A jurisdiction having a strategic Anti-Money Laundering or Combating the Financing of Terrorism deficiencies to which counter measures apply; or (ii) A jurisdiction that has not made sufficient progress in addressing the deficiencies or has not committed to an action plan developed with the Financial Action Task Force to address the deficiencies.

Further, IOSCO Compliant Country means a country whose securities market regulator is a signatory to the International Organisation of Securities Commission's (IOSCO's) Multilateral Memorandum of Understanding or a signatory to bilateral Memorandum of Understanding with the SEBI for information sharing arrangements.

## Minimum Average Maturity Period (MAMP)

Minimum Average Maturity Period (MAMP) for ECB will be 3 years. Call and put options, if any, shall not be exercisable prior to completion of minimum average maturity.

However, for the specific categories mentioned below, the Minimum Average Maturity Period (MAMP) are as under:

| Category  | Minimum Average Maturity Period (MAMP) |
|---|--|
| ECB raised by manufacturing companies up to USD 50 million or its equivalent per financial year   | 1 year                                 |
| ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans. It may be noted that: <ul style="list-style-type: none"> <li>(i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks</li> <li>(ii) the prescribed MAMP will have to be strictly complied with under all circumstances.</li> </ul>   | 5 year                                 |
| ECB raised for <ul style="list-style-type: none"> <li>(i) Working capital purposes or general corporate purposes</li> <li>(ii) on-lending by NBFCs for working capital purposes or general corporate purposes.</li> </ul> It may be noted that: <ul style="list-style-type: none"> <li>(i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks</li> <li>(ii) the prescribed MAMP will have to be strictly complied with under all circumstances.</li> </ul> | 10 year                                |

|   |          |
|---|----------|
| ECB raised for<br><br>(i) repayment of Rupee loans availed domestically for capital expenditure<br>(ii) on-lending by NBFCs for the same purpose.<br><br>It may be noted that:<br><br>(i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks<br>(ii) the prescribed MAMP will have to be strictly complied with under all circumstances.                     | 7 year   |
| ECB raised for<br><br>(i) repayment of Rupee loans availed domestically for purposes other than capital expenditure<br>(ii) on-lending by NBFCs for the same purpose.<br><br>It may be noted that:<br><br>(i) ECB cannot be raised from foreign branches / subsidiaries of Indian banks<br>(ii) the prescribed MAMP will have to be strictly complied with under all circumstances. | 10 years |

### All-In-Cost Ceiling per Annum

All-in-cost ceiling per annum is the Benchmark rate plus 450 bps spread.

It may be noted that All-in-Cost includes rate of interest, other fees, expenses, charges, guarantee fees, ECA charges, whether paid in foreign currency or INR but will not include commitment fees and withholding tax payable in INR. In the case of fixed rate loans, the swap cost plus spread should not be more than the floating rate plus the applicable spread. Additionally, for FCCBs, the issue related expenses should not exceed 4 per cent of the issue size and in case of private placement, these expenses should not exceed 2 per cent of the issue size, etc. Under Trade Credit (TC) Framework, all-in-cost shall include rate of interest, other fees, expenses, charges, guarantee fees whether paid in foreign currency or INR. Withholding tax payable in INR shall not be a part of all-in-cost. Various components of all-in-cost have to be paid by the borrower without taking recourse to the drawdown of ECB/TC, i.e., ECB/TC proceeds cannot be used for payment of interest/charges.

Further, Benchmark rate in case of Foreign Currency ECB refers to 6-months LIBOR rate of different currencies or any other 6-month interbank interest rate applicable to the currency of borrowing, for eg., EURIBOR. Benchmark rate in case of Rupee denominated ECB/TC will be prevailing yield of the Government of India securities of corresponding maturity.

### Other Costs

Prepayment charge/ Penal interest, if any, for default or breach of covenants, should not be more than 2 per cent over and above the contracted rate of interest on the outstanding principal amount and will be outside the all-in-cost ceiling.

### End-uses (Negative list)

The negative list, for which the ECB proceeds cannot be utilised, would include the following:

- Real estate activities.
- Investment in capital market.
- Equity investment.
- Working capital purposes, **except** ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans and **except** ECB raised for (i) working capital purposes or general corporate purposes (ii) on-lending by Non-Banking Financial Companies (NBFCs) for working capital purposes or general corporate purposes.

- General corporate purposes, **except** in case of ECB raised from foreign equity holder for working capital purposes, general corporate purposes or for repayment of Rupee loans *and except* ECB raised for (i) working capital purposes or general corporate purposes (ii) on-lending by NBFCs for working capital purposes or general corporate purposes.
- Repayment of Rupee loans, **except** in case of ECB raised for (i) repayment of Rupee loans availed domestically for capital expenditure (ii) on-lending by NBFCs for the same purpose *and except* ECB raised for (i) repayment of Rupee loans availed domestically for purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose.
- On-lending to entities for the above activities, **except** in case of ECB raised by NBFCs for (i) working capital purposes or general corporate purposes (ii) on-lending by NBFCs for working capital purposes or general corporate purposes *and* (i) repayment of Rupee loans availed domestically for capital expenditure (ii) on-lending by NBFCs for the same purpose *and except* ECB raised for (i) repayment of Rupee loans availed domestically for purposes other than capital expenditure (ii) on-lending by NBFCs for the same purpose.

### Exchange rate

Change of currency of Foreign Currency ECB into Indian Rupee ECB can be at the exchange rate prevailing on the date of the agreement for such change between the parties concerned or at an exchange rate, which is less than the rate prevailing on the date of the agreement, if consented to by the ECB lender.

For conversion to Rupee, the exchange rate shall be the rate prevailing on the date of settlement.

### Hedging Provision

The entities raising ECB are required to follow the guidelines for hedging issued, if any, by the concerned sectoral or prudential regulator in respect of foreign currency exposure. Infrastructure space companies shall have a Board approved risk management policy. Further, such companies are required to mandatorily hedge 70 per cent of their ECB exposure in case the average maturity of the ECB is less than 5 years. The designated AD Category-I bank shall verify that 70 per cent hedging requirement is complied with during the currency of the ECB and report the position to RBI through Form ECB 2.

The following operational aspects with respect to hedging should be ensured:

- Coverage:* The ECB borrower will be required to cover the principal as well as the coupon through financial hedges. The financial hedge for all exposures on account of ECB should start from the time of each such exposure (i.e. the day the liability is created in the books of the borrower).
- Tenor and rollover:* A minimum tenor of one year for the financial hedge would be required with periodic rollover, duly ensuring that the exposure on account of ECB is not unhedged at any point during the currency of the ECB.
- Natural Hedge:* Natural hedge, in lieu of financial hedge, will be considered only to the extent of offsetting projected cash flows / revenues in matching currency, net of all other projected outflows. For this purpose, an ECB may be considered naturally hedged if the offsetting exposure has the maturity/ cash flow within the same accounting year. Any other arrangements/ structures, where revenues are indexed to foreign currency will not be considered as a natural hedge

Overseas investors are eligible to hedge their exposure in Rupee through permitted derivative products with AD Category I banks in India. The investors can also access the domestic market through branches / subsidiaries of Indian banks abroad or branches of foreign banks with Indian presence on a back to back basis.

### Change of Currency of Borrowing

Change of currency of ECB from one freely convertible foreign currency to any other freely convertible foreign currency as well as to Indian Rupee is freely permitted.

Change of currency from Indian Rupee to any freely convertible foreign currency is not permitted.

It may be noted that the ECB framework is not applicable in respect of investments in Non-Convertible Debentures

in India made by Registered Foreign Portfolio Investors. Lending and borrowing under the ECB framework by Indian banks and their branches/subsidiaries outside India will be subject to prudential guidelines issued by the Department of Banking Regulation of the Reserve Bank. Further, other entities raising ECB are required to follow the guidelines issued, if any, by the concerned sectoral or prudential regulator.

### **Limit and Leverage**

All eligible borrowers can raise ECB up to USD 750 million or equivalent per financial year under the automatic route. Further, in case of Foreign Currency denominated ECB raised from direct foreign equity holder, ECB liability-equity ratio for ECB raised under the automatic route cannot exceed 7:1.

However, this ratio will not be applicable if the outstanding amount of all ECB, including the proposed one, is up to USD 5 million or its equivalent. Further, the borrowing entities will also be governed by the guidelines on debt equity ratio, issued, if any, by the sectoral or prudential regulator concerned.

### **Issuance of Guarantee, etc. by Indian banks and Financial Institutions**

Issuance of any type of guarantee by Indian banks, All India Financial Institutions and NBFCs relating to ECB is not permitted.

Further, financial intermediaries (viz., Indian banks, All India Financial Institutions, or Non-Banking Financial Companies) shall not invest in Foreign Currency Convertible Bonds/ Foreign Currency Exchangeable Bonds in any manner whatsoever.

### **Parking of ECB proceeds**

ECB proceeds are permitted to be parked abroad as well as domestically in the manner given below:

*Parking of ECB proceeds abroad:* ECB proceeds meant only for foreign currency expenditure can be parked abroad pending utilisation. Till utilisation, these funds can be invested in the following liquid assets (a) deposits or Certificate of Deposit or other products offered by banks rated not less than AA (-) by Standard and Poor/ Fitch IBCA or Aa3 by Moody's; (b) Treasury bills and other monetary instruments of one-year maturity having minimum rating as indicated above and (c) deposits with foreign branches/subsidiaries of Indian banks abroad.

*Parking of ECB proceeds domestically:* ECB proceeds meant for Rupee expenditure should be repatriated immediately for credit to their Rupee accounts with AD Category I banks in India. ECB borrowers are also allowed to park ECB proceeds in term deposits with AD Category I banks in India for a maximum period of 12 months cumulatively. These term deposits should be kept in unencumbered position.

### **Procedure of raising ECB**

All ECB can be raised under the automatic route if they conform to the parameters prescribed under this framework. For approval route cases, the borrowers may approach the RBI with an application in prescribed format (Form ECB) for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macroeconomic situation and merits of the specific proposals. ECB proposals received in the Reserve Bank above certain threshold limit (refixed from time to time) would be placed before the Empowered Committee set up by the Reserve Bank. The Empowered Committee will have external as well as internal members and the Reserve Bank will take a final decision in the cases taking into account recommendation of the Empowered Committee. Entities desirous to raise ECB under the automatic route may approach an AD Category I bank with their proposal along with duly filled in Form ECB.

### **Reporting Requirements**

Borrowings under ECB Framework are subject to following reporting requirements apart from any other specific reporting required under the framework:

*Loan Registration Number (LRN):* Any draw-down in respect of an ECB should happen only after obtaining the LRN from the Reserve Bank. To obtain the LRN, borrowers are required to submit duly certified Form ECB, which also

contains terms and conditions of the ECB, in duplicate to the designated AD Category I bank. In turn, the AD Category I bank will forward one copy to the Director, Reserve Bank of India, Department of Statistics and Information Management, External Commercial Borrowings Division, Bandra-Kurla Complex, Mumbai – 400 051. Copies of loan agreement for raising ECB are not required to be submitted to the Reserve Bank.

*Changes in terms and conditions of ECB:* Changes in ECB parameters in consonance with the ECB norms, including reduced repayment by mutual agreement between the lender and borrower, should be reported to the Department of Statistics and Information Management through revised Form ECB at the earliest, in any case not later than 7 days from the changes effected. While submitting revised Form ECB the changes should be specifically mentioned in the communication.

*Monthly Reporting of actual transactions:* The borrowers are required to report actual ECB transactions through Form ECB 2 Return through the AD Category I bank on monthly basis so as to reach Department of Statistics and Information Management within seven working days from the close of month to which it relates. Changes, if any, in ECB parameters should also be incorporated in Form ECB 2 Return.

*Late Submission Fee (LSF) for delay in reporting:* Any borrower, who is otherwise in compliance of ECB guidelines, can regularise the delay in reporting of drawdown of ECB proceeds before obtaining LRN or delay in submission of Form ECB 2 returns, by payment of prescribed late submission fees.

*Standard Operating Procedure (SOP) for Untraceable Entities:* The following SOP has to be followed by designated AD Category-I banks in case of untraceable entities who are found to be in contravention of reporting provisions for ECB by failing to submit prescribed return(s) under the ECB framework, either physically or electronically, for past eight quarters or more.

Any borrower who has raised ECB will be treated as 'untraceable entity', if entity/auditor(s)/director(s)/promoter(s) of entity are not reachable/responsive/reply in negative over email/letters/phone for a period of not less than two quarters with documented communication/ reminders numbering 6 or more and it fulfills both of the following conditions:

- Entity not found to be operative at the registered office address as per records available with the AD Bank or not found to be operative during the visit by the officials of the AD Bank or any other agencies authorised by the AD bank for the purpose;
- Entities have not submitted Statutory Auditor's Certificate for last two years or more;

The followings actions are to be undertaken in respect of 'untraceable entities':

- File Revised Form ECB, if required, and last Form ECB 2 Return without certification from company with 'UNTRACEABLE ENTITY' written in bold on top. The outstanding amount will be treated as written-off from external debt liability of the country but may be retained by the lender in its books for recovery through judicial/ non-judicial means;
- No fresh ECB application by the entity should be examined/processed by the AD bank;
- Directorate of Enforcement should be informed whenever any entity is designated 'UNTRACEABLE ENTITY'; and
- No inward remittance or debt servicing will be permitted under auto route.

## Conversion of ECB into Equity

Conversion of ECB, including those which are matured but unpaid, into equity is permitted subject to the following conditions:

- i. The activity of the borrowing company is covered under the automatic route for Foreign Direct Investment or Government approval is received, wherever applicable, for foreign equity participation as per extant Foreign Direct Investment policy.
- ii. The conversion, which should be with the lender's consent and without any additional cost, should not result in contravention of eligibility and breach of applicable sector cap on the foreign equity holding under Foreign Direct Investment policy;

- iii. Applicable pricing guidelines for shares are complied with;
- iv. In case of partial or full conversion of ECB into equity, the reporting to the Reserve Bank will be as under:
  - For partial conversion, the converted portion is to be reported in Form FC-GPR prescribed for reporting of FDI flows, while monthly reporting to DSIM in Form ECB 2 Return will be with suitable remarks, viz., "ECB partially converted to equity".
  - For full conversion, the entire portion is to be reported in Form FC-GPR, while reporting to DSIM in Form ECB 2 Return should be done with remarks "ECB fully converted to equity". Subsequent filing of Form ECB 2 Return is not required.
  - For conversion of ECB into equity in phases, reporting through Form FC-GPR and Form ECB 2 Return will also be in phases.
- v. If the borrower concerned has availed of other credit facilities from the Indian banking system, including foreign branches/subsidiaries of Indian banks, the applicable prudential guidelines issued by the Department of Banking Regulation of Reserve Bank, including guidelines on restructuring are complied with;
- vi. Consent of other lenders, if any, to the same borrower is available or atleast information regarding conversions is exchanged with other lenders of the borrower.
- vii. For conversion of ECB dues into equity, the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender. It may be noted that the fair value of the equity shares to be issued shall be worked out with reference to the date of conversion only.

## Security for raising ECB

AD Category I banks are permitted to allow creation/cancellation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees in favour of overseas lender / security trustee, to secure the ECB to be raised/ raised by the borrower, subject to satisfying themselves that:

- the underlying ECB is in compliance with the extant ECB guidelines,
- there exists a security clause in the Loan Agreement requiring the ECB borrower to create/cancel charge, in favour of overseas lender/security trustee, on immovable assets/movable assets/financial securities/ issuance of corporate and/or personal guarantee, and
- No objection certificate, as applicable, from the existing lenders in India has been obtained in case of creation of charge.

Once the aforesaid stipulations are met, the AD Category I bank may permit creation of charge on immovable assets, movable assets, financial securities and issue of corporate and/or personal guarantees, during the currency of the ECB with security co-terminating with underlying ECB, subject to the following:

*Creation of Charge on Immovable Assets:* The arrangement shall be subject to the following:

- Such security shall be subject to provisions contained in the Foreign Exchange Management (Acquisition and Transfer of Immovable Property in India) Regulations, 2017, as amended from time to time.
- The permission should not be construed as a permission to acquire immovable asset (property) in India, by the overseas lender/ security trustee.
- In the event of enforcement / invocation of the charge, the immovable asset/ property will have to be sold only to a person resident in India and the sale proceeds shall be repatriated to liquidate the outstanding ECB.

*Creation of Charge on Movable Assets:* In the event of enforcement/ invocation of the charge, the claim of the lender, whether the lender takes over the movable asset or otherwise, will be restricted to the outstanding claim against the ECB. Encumbered movable assets may also be taken out of the country subject to getting 'No Objection Certificate' from domestic

*Creation of Charge over Financial Securities:* The arrangements may be permitted subject to the following:

- Pledge of shares of the borrowing company held by the promoters as well as in domestic associate companies of the borrower is permitted. Pledge on other financial securities, viz. bonds and debentures, Government

Securities, Government Savings Certificates, deposit receipts of securities and units of the Unit Trust of India or of any mutual funds, standing in the name of ECB borrower/promoter, is also permitted.

- In addition, security interest over all current and future loan assets and all current assets including cash and cash equivalents, including Rupee accounts of the borrower with ADs in India, standing in the name of the borrower/promoter, can be used as security for ECB. The Rupee accounts of the borrower/ promoter can also be in the form of escrow arrangement or debt service reserve account.
- In case of invocation of pledge, transfer of financial securities shall be in accordance with the extant FDI/ FII policy including provisions relating to sectoral cap and pricing as applicable read with the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017, as amended from time to time.

*Issue of Corporate or Personal Guarantee:* The arrangement shall be subject to the following:

- A copy of Board Resolution for the issue of corporate guarantee for the company issuing such guarantee, specifying name of the officials authorised to execute such guarantees on behalf of the company or in individual capacity should be obtained.
- Specific requests from individuals to issue personal guarantee indicating details of the ECB should be obtained.
- Such security shall be subject to provisions contained in the Foreign Exchange Management (Guarantees) Regulations, 2000, as amended from time to time.
- ECB can be credit enhanced / guaranteed / insured by overseas party/ parties only if it/ they fulfil/s the criteria of recognised lender under extant ECB guidelines.

### ECB facility for Oil Marketing Companies

Public Sector Oil Marketing Companies (OMCs) can raise ECB for working capital purposes with minimum average maturity period of 3 years from all recognised lenders under the automatic route without mandatory hedging and individual limit requirements. The overall ceiling for such ECB shall be USD 10 billion or equivalent. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECB. All other provisions under the ECB framework will be applicable to such ECB.

### ECB facility for Startups

AD Category-I banks are permitted to allow Startups to raise ECB under the automatic route as per the following framework:

- *Eligibility:* An entity recognised as a Startup by the Central Government as on date of raising ECB.
- *Maturity:* Minimum average maturity period will be 3 years.
- *Recognised lender:* Lender / investor shall be a resident of a FATF compliant country. However, foreign branches/subsidiaries of Indian banks and overseas entity in which Indian entity has made overseas direct investment as per the extant Overseas Direct Investment Policy will not be considered as recognised lenders under this framework.
- *Forms:* The borrowing can be in form of loans or non-convertible, optionally convertible or partially convertible preference shares.
- *Currency:* The borrowing should be denominated in any freely convertible currency or in Indian Rupees (INR) or a combination thereof. In case of borrowing in INR, the non-resident lender, should mobilise INR through swaps/outright sale undertaken through an AD Category-I bank in India.
- *Amount:* The borrowing per Startup will be limited to USD 3 million or equivalent per financial year either in INR or any convertible foreign currency or a combination of both.
- *All-in-cost:* Shall be mutually agreed between the borrower and the lender.
- *End uses:* For any expenditure in connection with the business of the borrower.
- *Conversion into equity:* Conversion into equity is freely permitted subject to Regulations applicable for foreign investment in Startups.

- *Security:* The choice of security to be provided to the lender is left to the borrowing entity. Security can be in the nature of movable, immovable, intangible assets (including patents, intellectual property rights), financial securities, etc. and shall comply with foreign direct investment / foreign portfolio investment / or any other norms applicable for foreign lenders / entities holding such securities. Further, issuance of corporate or personal guarantee is allowed. Guarantee issued by a non-resident(s) is allowed only if such parties qualify as lender under ECB for Startups. However, issuance of guarantee, standby letter of credit, letter of undertaking or letter of comfort by Indian banks, all India Financial Institutions and NBFCs is not permitted.
- *Hedging:* The overseas lender, in case of INR denominated ECB, will be eligible to hedge its INR exposure through permitted derivative products with AD Category – I banks in India. The lender can also access the domestic market through branches/ subsidiaries of Indian banks abroad or branches of foreign bank with Indian presence on a back to back basis. Startups raising ECB in foreign currency, whether having natural hedge or not, are exposed to currency risk due to exchange rate movements and hence are advised to ensure that they have an appropriate risk management policy to manage potential risk arising out of ECB.
- *Conversion rate:* In case of borrowing in INR, the foreign currency - INR conversion will be at the market rate as on the date of agreement.
- *Other Provisions:* Other provisions like parking of ECB proceeds, reporting arrangements, powers delegated to AD banks, borrowing by entities under investigation, conversion of ECB into equity will be as included in the ECB framework.

### Borrowing by Entities under Investigation

All entities against which investigation / adjudication / appeal by the law enforcing agencies for violation of any of the provisions of the Regulations under FEMA pending, may raise ECB as per the applicable norms, if they are otherwise eligible, notwithstanding the pending investigations / adjudications / appeals, without prejudice to the outcome of such investigations / adjudications / appeals. The borrowing entity shall inform about pendency of such investigation / adjudication / appeal to the AD Category-I bank / RBI as the case may be. Accordingly, in case of all applications where the borrowing entity has indicated about the pending investigations / adjudications/ appeals, the AD Category I Banks / Reserve Bank while approving the proposal shall intimate the agencies concerned by endorsing a copy of the approval letter.

### ECB by entities under restructuring/ ECB facility for refinancing stressed assets

An entity which is under a restructuring scheme/ corporate insolvency resolution process can raise ECB only if specifically permitted under the resolution plan. Eligible corporate borrowers who have availed Rupee loans domestically for capital expenditure in manufacturing and infrastructure sector and which have been classified as SMA-2 or NPA can avail ECB for repayment of these loans under any one time settlement with lenders. Lender banks are also permitted to sell, through assignment, such loans to eligible ECB lenders, provided, the resultant external commercial borrowing complies with all-in-cost, minimum average maturity period and other relevant norms of the ECB framework. Foreign branches/ overseas subsidiaries of Indian banks are not eligible to lend for the above purposes. The applicable MAMP will have to be strictly complied with under all circumstances.

Eligible borrowers under the ECB framework, who are participating in the Corporate Insolvency Resolution Process under Insolvency and Bankruptcy Code, 2016 as resolution applicants, can raise ECB from all recognised lenders, except foreign branches/subsidiaries of Indian banks, for repayment of Rupee term loans of the target company.

**LESSON ROUND-UP**

- External Commercial Borrowings are commercial loans raised by eligible resident entities from recognised non-resident entities and should conform to parameters such as minimum maturity, permitted and non-permitted end-uses, maximum all-in-cost ceiling, etc.
- External Commercial Borrowings Framework enables permitted resident entities to borrow from recognized non-resident entities.
- For conversion of ECB dues into equity, the exchange rate prevailing on the date of the agreement between the parties concerned for such conversion or any lesser rate can be applied with a mutual agreement with the ECB lender.
- Under External Commercial Borrowings Framework, borrowers may approach the RBI with an application in prescribed format Form ECB for examination through their AD Category I bank. Such cases shall be considered keeping in view the overall guidelines, macroeconomic situation and merits of the specific proposals.
- Borrowings under ECB Framework are subject to reporting requirements Loan Registration Number, Changes in terms and conditions of ECB and Reporting of actual transactions.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. What are the framework for raising ECB?
2. What precautions have to be taken before raising loan from overseas?
3. Whose responsibility is to ensure compliance with ECB guidelines?
4. Discuss the eligibility for raising ECB.
5. Enumerate the reporting requirements in respect of ECB.



## Lesson 9

# Foreign Trade Policy and Procedure

### ***Key Concepts One Should Know***

- Capital Goods
- Counter Trade
- Domestic Tariff Area
- Status holder
- Standard Input Output Norms
- Indian Trade Classification (Harmonized System)

### ***Learning Objectives***

#### **To understand:**

- India's Foreign Trade Policy (FTP)
- Government's "Make in India" initiative
- Importer-Exporter Code (IEC) Number/e-IEC
- Required Documents for Export/Import of Goods From/into India; Merchandise Exports from India Scheme (MEIS)
- Service Exports from India Scheme (SEIS)
- Duty Exemption / Remission Schemes
- Export Oriented Units (EOUS)

### ***Regulatory Framework***

- Foreign Trade (Development and Regulation) Act, 1992
- Foreign Trade Policy & Procedure

### ***Lesson Outline***

- Introduction
- Focus of the Foreign Trade Policy
- Legal Basis of Foreign Trade Policy
- Transitional Arrangements
- Importer-Exporter Code (IEC) number/e-IEC
- Merchandise Exports from India Scheme (MEIS)
- Service Exports from India Scheme (SEIS)
- Status Holder
- Duty Exemption/Remission Schemes
- Duty Free Import Authorisation Scheme (DFIA)
- Schemes for Exporters of Gems and Jewellery
- Export Promotion Capital Goods (EPCG) Scheme
- Export Oriented Units (EOUs), Electronics Hardware, Technology Parks (EHTPs), Software Technology Parks, (STPs) and BioTechnology Parks (BTPs)
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

India's Foreign Trade Policy (FTP) has, conventionally, been formulated for five years at a time and reviewed annually. The focus of the FTP has been to provide a framework of rules and procedures for exports and imports and a set of incentives for promoting exports. The FTP for 2015-2020 seeks to achieve the following objectives:

To provide a stable and sustainable policy environment for foreign trade in merchandise and services

To link rules, procedures and incentives for exports and imports with other initiatives such as "Make in India", "Digital India" and "Skills India" to create an "Export Promotion Mission" for India

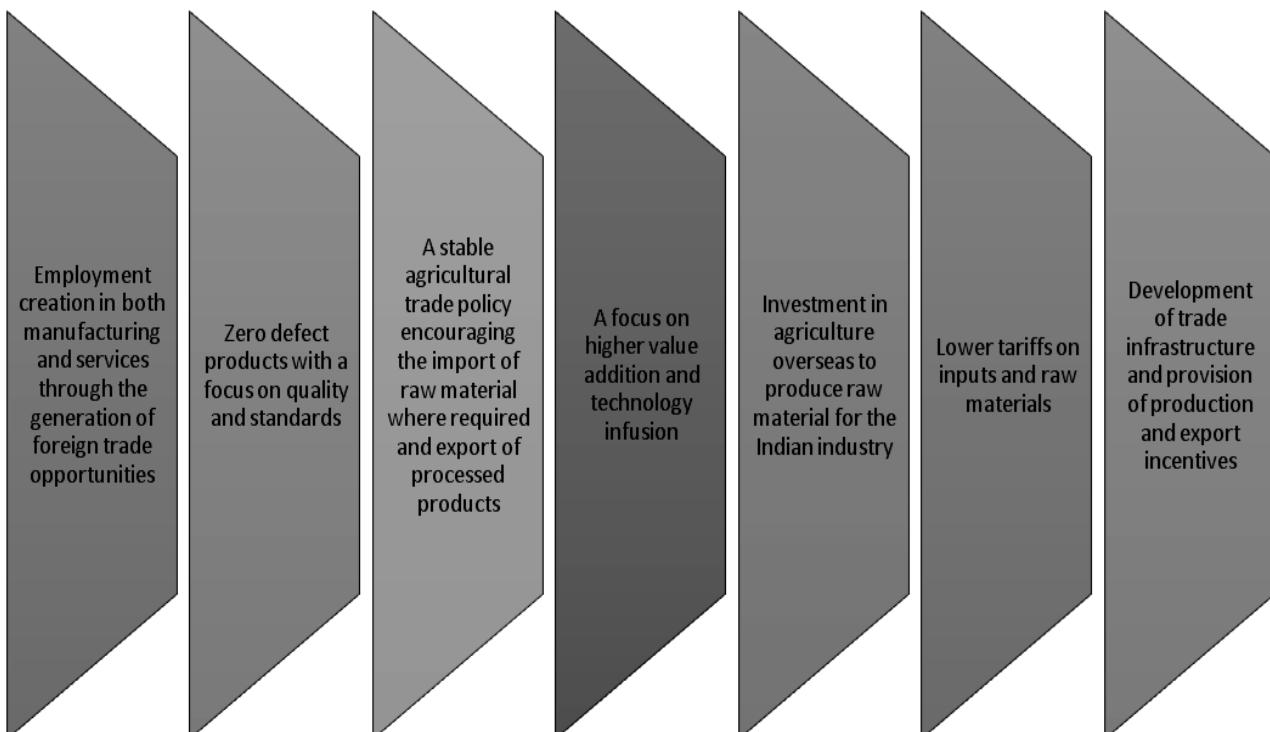
To promote the diversification of India's export basket by helping various sectors of the Indian economy to gain global competitiveness with a view to promoting exports

To create an architecture for India's global trade engagement with a view to expanding its markets and better integrating with major regions, thereby increasing the demand for India's products and contributing to the government's flagship "Make in India" initiative

To provide a mechanism for regular appraisal in order to rationalise imports and reduce the trade imbalance

Exports should not merely be a function of marketable surplus but should also reflect an enhancement of economic capacity and development. Foreign Trade Policy envisages:

Foreign Trade Policy envisages:-



## Focus of the Foreign Trade Policy (FTP)

The Foreign Trade Policy is primarily focused on accelerating exports. This is sought to be implemented through various schemes intended to exempt and remit indirect taxes on inputs physically incorporated in the export product, import capital goods at concessional duty, stimulate services exports and focus on specific markets and products. The Policy attempts to dovetail these schemes with the specific market access openings that India has achieved through negotiations with its trading partners for various bilateral and regional trading arrangements.

## Legal Basis of Foreign Trade Policy (FTP)

The Foreign Trade Policy 2015-20, is notified by Central Government, in exercise of powers conferred under Section 5 of the Foreign Trade (Development & Regulation) Act, 1992, as amended. The Foreign Trade Policy, 2015-20 came into force with effect from 01.04.2015

## Amendment to Foreign Trade Policy (FTP)

Central Government, in exercise of powers conferred by Section 5 of FT (D&R) Act, 1992, as amended from time to time, reserves the right to make any amendment to the FTP, by means of notification, in public interest.

## Duration of Foreign Trade Policy (FTP)

The Foreign Trade Policy (FTP), 2015-2020, incorporating provisions relating to export and import of goods and services, shall come into force with effect from the date of notification and shall remain in force up to 31st March, 2020, unless otherwise specified. All exports and imports made upto the date of notification shall, accordingly, be governed by the relevant FTP, unless otherwise specified.

## Transitional Arrangements

Any License/Authorisation / Certificate / Scrip / any instrument bestowing financial or fiscal benefit issued before commencement of FTP 2015-20 shall continue to be valid for the purpose and duration for which such License/ Authorisation/Certificate/Scrip/any instrument bestowing financial or fiscal benefit Authorisation was issued, unless otherwise stipulated.

In case an export or import that is permitted freely under FTP is subsequently subjected to any restriction or regulation, such export or import will ordinarily be permitted, notwithstanding such restriction or regulation, unless otherwise stipulated. This is subject to the condition that the shipment of export or import is made within the original validity period of an irrevocable commercial letter of credit, established before the date of imposition of such restriction and it shall be restricted to the balance value and quantity available and time period of such irrevocable letter of credit. For operationalising such irrevocable letter of credit, the applicant shall have to register the Letter of Credit with jurisdictional Regional Authority (RA) against computerized receipt, within 15 days of the imposition of any such restriction or regulation.

## DEFINITIONS

For purpose of Foreign Trade Policy, unless context otherwise requires, the following words and expressions shall have the following meanings attached to them:-

**"Accessory" or "Attachment"** means a part, sub-assembly or assembly that contributes to efficiency or effectiveness of a piece of equipment without changing its basic functions.

**"Act"** means Foreign Trade (Development and Regulation) Act, 1992 (No.22 of 1992) [FT (D&R) Act] as amended from time to time.

**"Actual User"** is a person (either natural or legal) who is authorized to use imported goods in his/its own premise which has a definitive postal address.

**(a) "Actual User (Industrial)"** is a person (either natural & legal) who utilizes imported goods for manufacturing in his own industrial unit or manufacturing for his own use in another unit including a jobbing unit which has a definitive postal address.

**(b) "Actual User (Non-Industrial)"** is a person (either natural & legal) who utilizes the imported goods for his own use in:

- (i) any commercial establishment, carrying on any business, trade or profession, which has a definitive postal address; or
- (ii) any laboratory, Scientific or Research and Development (R&D) institution, university or other educational institution or hospital which has a definitive postal address; or
- (iii) any service industry which has a definitive postal address.

**"AEZ"** means Agricultural Export Zones notified by Director General of Foreign Trade (DGFT) in Appendix 2V of Appendices and Aayat Niryat Forms of FTP 2015.

**"Appeal"** is an application filed under section 15 of the Act and includes such applications preferred by DGFT officials in government interest against decision by designated adjudicating/appellate authorities.

**"Applicant"** means person on whose behalf an application is made and shall, wherever context so requires, includes person signing the application.

**"Authorization"** means permission as included in Section 2 (g) of the Act to import or export as per provisions of FTP.

**"Capital Goods"** means any plant, machinery, equipment or accessories required for manufacture or production, either directly or indirectly, of goods or for rendering services, including those required for replacement, modernisation, technological up-gradation or expansion. It includes packaging machinery and equipment, refrigeration equipment, power generating sets, machine tools, equipment and instruments for testing, research and development, quality and pollution control. Capital goods may be for use in manufacturing, mining, agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture and viticulture as well as for use in services sector.

**"Competent Authority"** means an authority competent to exercise any power or to discharge any duty or function under the Act or the Rules and Orders made there under or under FTP.

**"Component"** means one of the parts of a sub-assembly or assembly of which a manufactured product is made up and into which it may be resolved. A component includes an accessory or attachment to another component.

**"Consumables"** means any item, which participates in or is required for a manufacturing process, but does not necessarily form part of end-product. Items, which are substantially or totally consumed during a manufacturing process, will be deemed to be consumables.

**"Consumer Goods"** means any consumption goods, which can directly satisfy human needs without further processing and includes consumer durables and accessories thereof.

**"Counter Trade"** means any arrangement under which exports/imports from /to India are balanced either by direct imports/exports from importing/exporting country or through a third country under a Trade Agreement or otherwise. Exports/ Imports under Counter Trade may be carried out through Escrow Account, Buy Back arrangements, Barter trade or any similar arrangement. Balancing of exports and imports could wholly or partly be in cash, goods and/or services.

**"Developer"** means a person or body of persons, company, firm and such other private or government undertaking, who develops, builds, designs, organises, promotes, finances, operates, maintains or manages a part or whole of infrastructure and other facilities in SEZ as approved by Central Government and also includes a co- developer.

**"Development Commissioner"** means Development Commissioner of Special Economic Zone (SEZ).

**"Domestic Tariff Area (DTA)"** means area within India which is outside SEZs and Export Oriented Undertaking (EOU)/Electronic Hardware Technology Park (EHTP)/Software Technology Park (STP) Biotechnology Park (BTP).

**“Drawback on deemed export”** in relation to any goods manufactured in India and supplied as deemed exports, means the rebate of duty or tax, as the case may be, chargeable on any imported materials or excisable materials used or taxable services used as input services in the manufacture of such goods.

**“EOU”** means Export Oriented Unit for which a letter of permit has been issued by Development Commissioner.

**“Excisable goods”** means any goods produced or manufactured in India and subject to duty of excise under Central Excise and Salt Act 1944 (1 of 1944).

**“Export”** is as defined in FT (D&R) Act, 1992, as amended from time to time.

**“Exporter”** means a person who exports or intends to export and holds an IEC number, unless otherwise specifically exempted.

**“Export Obligation”** means obligation to export product or products covered by Authorisation or permission in terms of quantity, value or both, as may be prescribed or specified by Regional or competent authority.

**“Free”** as appearing in context of import/export policy for items means goods which do not need any ‘Authorisation’/ License or permission for being imported into the country or exported out.

**“FTP”** means the Foreign Trade Policy which specifies policy for exports and imports under Section 5 of the Act.

**“Import”** is as defined in FT (D&R) Act, 1992 as amended from time to time.

**“Importer”** means a person who imports or intends to import and holds an Import Export Number (IEC) number, unless otherwise specifically exempted.

**ITC (HS)** refers to Indian Trade Classification (Harmonized System) at 8 digits.

**“Jobbing”** means processing or working upon of raw materials or semi-finished goods supplied to job worker, so as to complete a part of process resulting in manufacture or finishing of an article or any operation which is essential for aforesaid process.

**“Licensing Year”** means period beginning on the 1st April of a year and ending on the 31st March of the following year.

**“Managed Hotel”** means hotels managed by a three star or above hotel/ hotel chain under an operating management contract for a duration of at least three years between operating hotel/ hotel chain and hotel being managed. Management contract must necessarily cover the entire gamut of operations/ management of managed hotel.

**“Manufacture”** means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, re-packing, polishing, labelling, Re-conditioning repair, remaking, refurbishing, testing, calibration, re-engineering.

Manufacture, for the purpose of FTP, shall also include agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining.

**“Manufacturer Exporter”** means a person who exports goods manufactured by him or intends to export such goods.

**“Merchant Exporter”** means a person engaged in trading activity and exporting or intending to export goods.

**“NC”** means the Norms Committee in the Directorate General of Foreign Trade for approval of adhoc input – output norms in cases where SION does not exist and recommend SION to be notified in DGFT.

**“Notification”** means a notification published in Official Gazette.

**“Order”** means an Order made by Central Government under the Act.

**“Part”** means an element of a sub-assembly or assembly not normally useful by itself, and not amenable to further disassembly for maintenance purposes. A part may be a component, spare or an accessory.

**“Person”** means both natural and legal and includes an individual, firm, society, company, corporation or any other legal person including the DGFT officials.

**“Policy”** means Foreign Trade Policy (2015-2020) as amended from time to time.

**“Prescribed”** means prescribed under the Act or the Rules or Orders made there under or under FTP.

**“Prohibited”** indicates the import/export policy of an item, as appearing in ITC (HS) or elsewhere, whose import or export is not permitted.

**“Public Notice”** means a notice published under provisions of paragraph 2.04 of FTP.

**“Quota”** means the quantity of goods of a specific kind that is permitted to be imported without restriction or imposition of additional Duties.

**“Raw material”** means input(s) needed for manufacturing of goods. These inputs may either be in a raw/ natural/ unrefined/ unmanufactured or manufactured state.

**“Regional Authority”** means authority competent to grant an Authorisation under the Act/Order.

**“Registration-Cum-Membership Certificate”** (RCMC) means certificate of registration and membership granted by an Export Promotion Council/Commodity Board/Development Authority or other competent authority as prescribed in FTP or Handbook of Procedures.

**“Restricted”** is a term indicating the import or export policy of an item, which can be imported into the country or exported outside, only after obtaining an authorization from the offices of DGFT.

**“Rules”** means Rules made by Central Government under Section 19 of the FT (D&R) Act.

**“SCOMET”** is the nomenclature for dual use items of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET). Export of dual-use items and technologies under India’s Foreign Trade Policy is regulated. It is either prohibited or is permitted under an authorization.

**“Services”** include all tradable services covered under General Agreement on Trade in Services (GATS) and earning free foreign exchange. “Service Provider” means a person providing:

- (i) Supply of a ‘service’ from India to any other country; (Mode1- Cross border trade)
- (ii) Supply of a ‘service’ from India to service consumer(s) of any other country; (Mode 2-Consumption abroad)
- (iii) Supply of a ‘service’ from India through commercial presence in any other country. (Mode 3 – Commercial Presence.)
- (iv) Supply of a ‘service’ from India through the presence of natural persons in any other country (Mode 4- Presence of natural persons.)

**“Ships”** mean all types of vessels used for sea borne trade or coastal trade, and shall include second hand vessels.

**“SION”** means Standard Input Output Norms notified by DGFT.

**“Spares”** means a part or a sub-assembly or assembly for substitution that is ready to replace an identical or similar part or sub- assembly or assembly. Spares include a component or an accessory.

**“Specified”** means specified by or under the provisions of this Policy through Notification/Public Notice.

**“Status holder”** means an exporter recognized as One Star Export House/ Two Star Export House/Three Star Export House/Four Star Export House/ Five Star Export House by DGFT/ Development Commissioner.

**“Stores”** means goods for use in a vessel or aircraft and includes fuel and spares and other articles of equipment, whether or not for immediate fitting.

“Supporting Manufacturer” is one who manufactures goods/products or any part/accessories/ components of a good/product for a merchant exporter or a manufacturer exporter under a specific authorization.

“Supporting Manufacturer” for the EPCG Scheme shall be one in whose premises/factory Capital Goods imported/ procured under EPCG authorization is installed.

**State Trading Enterprises (STEs)**, for the purpose of this FTP, are those entities which are granted exclusive right/ privileges export and/or import as per FTP.

**"Third-party exports"** means exports made by an exporter or manufacturer on behalf of another exporter(s).

In such cases, export documents such as shipping bills shall indicate name of manufacturing exporter/ manufacturer and third party exporter(s). Bank Realisation Certificate, Self Declaration Form (SDF), export order and invoice should be in the name of third party exporter.

**"Transaction Value"** is as defined in Customs Valuation Rules of Department of Revenue.

## GENERAL PROVISIONS REGARDING IMPORTS AND EXPORTS

### Exports and Imports – 'Free', unless regulated

- (a) Exports and Imports shall be 'Free' except when regulated by way of 'prohibition', 'restriction' or 'exclusive trading through State Trading Enterprises (STEs)' as laid down in Indian Trade Classification (Harmonised System) [ITC (HS)] of Exports and Imports.
- (b) Further, there are some items which are 'free' for import/export, but subject to conditions stipulated in other Acts or in law for the time being in force.

### Indian Trade Classification (Harmonised System) [ITC (HS)] of Exports and Imports

- (a) ITC (HS) is a compilation of codes for all merchandise/goods for export/ import. Goods are classified based on their group or sub-group at 2/4/6/8 digits.
- (b) ITC (HS) is aligned at 6 digit level with international Harmonized System goods nomenclature maintained by World Customs Organization (<http://www.wcoomd.org>). However, India maintains national Harmonized System of goods at 8 digit level which may be viewed by clicking on 'Downloads' at <http://dgft.gov.in>.
- (c) The import/export policies for all goods are indicated against each item in ITC (HS). Schedule 1 of ITC (HS) lays down the Import Policy regime while Schedule 2 of ITC (HS) details the Export Policy regime.
- (d) Except where it is clearly specified, Schedule 1 of ITC (HS), Import Policy is for new goods and not for the Second Hand goods.

### Compliance of Imports with Domestic Laws

- (a) Domestic Laws/ Rules/ Orders/ Regulations/Technical specifications/ environmental/ safety and health norms applicable to domestically produced goods shall apply, mutatis mutandis, to imports, unless specifically exempted.
- (b) However, goods to be utilized/ consumed in manufacture of export products, as notified by DGFT, may be exempted from domestic standards/quality specifications.

### Authority to specify Procedures

Director General of Foreign Trade (DGFT) may specify procedure to be followed by an exporter or importer or by any licensing/Regional Authority (RA) or by any other authority for purposes of implementing provisions of FT (D&R) Act, the Rules and the Orders made there under and FTP. Such procedure, or amendments, if any, shall be published by means of a Public Notice.

## IMPORTER-EXPORTER CODE (IEC) NUMBER/E-IEC

An IEC is a 10-digit number allotted to a person that is mandatory for undertaking any export / import activities. Now the facility for IEC in electronic form or e-IEC has also been operationalised.

- (a) Application for obtaining IEC can be filed manually and submitting the form in the office of Regional Authority (RA) of DGFT. Alternatively, Exporters/Importers shall file an application in ANF 2A format for grant of e-IEC. Those who have digital signatures can sign and submit the application online along with the requisite documents. Others may take a printout of the application, sign the undertaking/ declaration, upload the same with other requisite documents and thereafter submit the signed copy of the online application form to concerned jurisdictional Regional Authorities (RA) either through post or by hand.

- (b) Deficiency in the application form has to be removed by re-logging onto “Online IEC application” on DGFT website and filling the form again by paying the requisite application processing charges.
- (c) When an e-IEC is approved by the competent authority, applicant is informed through e-mail that a computer generated e-IEC is available on the DGFT website. By clicking on “Application Status” after having filled and submitted the requisite details in “Online IEC Application” webpage, applicant can view and print his e-IEC.

***Briefly, following are the requisite details/documents (scanned copies) to be submitted/ uploaded along with the application for IEC:***

- (i) Details of the entity seeking the IEC:
  - (1) PAN of the business entity in whose name Import/Export would be done (Applicant individual in case of Proprietorship firms).
  - (2) Address Proof of the applicant entity.
  - (3) LLPIN /CIN/ Registration Certification Number (whichever is applicable).
  - (4) Bank account details of the entity. Cancelled Cheque bearing entity's pre-printed name or Bank certificate in prescribed format ANF2A(I).
- (ii) Details of the Proprietor/ Partners/ Directors/ Secretary or Chief Executive of the Society/ Managing Trustee of the entity:
  - (1) PAN (for all categories)
  - (2) DIN/DPIN (in case of Company /LLP firm)
- (iii) Details of the signatory applicant:
  - (1) Identity proof
  - (2) PAN
  - (3) Digital photograph
- (d) In case the applicant has digital signature, the application can also be submitted online and no physical application or document is required. In case the applicant does not possess digital signature, a print out of the application filed online duly signed by the applicant has to be submitted to the concerned jurisdictional RA, in person or by post.

### **No Export/Import without IEC**

No export or import shall be made by any person without obtaining an IEC number unless specifically exempted.

- (a) The following categories of importers or exporters are exempted from obtaining IEC.

### **IEC Number Exempted Categories**

| Sl. No. | Categories Exempted from obtaining IEC   |
|---------|--|
| (i)     | Importers covered by clause 3(1) [except sub- clauses (e) and (l)] and exporters covered by clause 3(2) [except sub-clauses (i) and (k)] of Foreign Trade (Exemption from application of Rules in certain cases) Order, 1993.  |
| (ii)    | Ministries /Departments of Central or State Government   |
| (iii)   | Persons importing or exporting goods for personal use not connected with trade or manufacture or agriculture.  |
| (iv)    | Persons importing/exporting goods from/to Nepal, Myanmar through Indo-Myanmar border areas and China (through Gunji, Namgaya, Shipkila and Nathula ports), provided CIF value of a single consignment does not exceed Indian Rs.25,000. In case of Nathula port, the applicable value ceiling will be Rs. 1,00,000/- |

Further, exemption from obtaining IEC shall not be applicable for export of Special Chemicals, Organisms, Materials, Equipments and Technologies (SCOMET) as listed in Appendix - 3, Schedule 2 of ITC (HS) except in case of exports by category (ii) above.

(b) Following permanent IEC numbers shall be used by non - commercial Public Sector Undertaking (PSUs) and categories or importers/exporters mentioned against them for import/export purposes:

| Sr. No. | Permanent IEC | Categories of Importer / Exporter   |
|---------|---------------|---|
| 1       | 0100000011    | All Ministries / Departments of Central Government and agencies wholly or partially owned by them.  |
| 2       | 0100000029    | All Ministries/Departments of any State Government and agencies wholly or partially owned by them.  |
| 3       | 0100000037    | Diplomatic personnel, Counsellor officers in India and officials of UNO and its specialised agencies.   |
| 4       | 0100000045    | Indians returning from/going abroad and claiming benefit under Baggage Rules.   |
| 5       | 0100000053    | Persons/Institutions/Hospitals importing or exporting goods for personal use, not connected with trade or manufacture or agriculture.   |
| 6       | 0100000061    | Persons importing / exporting goods from /to Nepal  |
| 7       | 0100000070    | Persons importing / exporting goods from/to Myanmar through Indo-Myanmar border areas   |
| 8       | 0100000088    | Ford Foundation.  |
| 9       | 0100000096    | Importers importing goods for display or use in fairs/exhibitions or similar events under provisions of ATA carnet. This IEC number can also be used by importers importing for exhibitions / fairs as per Paragraph 2.63 of Handbook of Procedures |
| 10      | 0100000100    | Director, National Blood Group  |
| 11      | 0100000126    | Individuals/Charitable Institution/Registered NGOs importing goods, which have been exempted from Customs duty under Notification issued by Ministry of Finance for bonafide use by victims affected by natural calamity.                           |
| 12      | 0100000134    | Persons importing/exporting permissible goods as notified from time to time, from /to China through Gunji, Namgaya Shipkila and Nathula ports, subject to value ceilings of single consignment as given in a (iv) above.                            |
| 13      | 0100000169    | Non-commercial imports and exports by entities who have been authorised by Reserve Bank of India.   |

### Only one IEC against one Permanent Account Number (PAN)

Only one IEC is permitted against on Permanent Account Number (PAN). If any PAN card holder has more than one IEC, the extra IECs shall be disabled.

### MANDATORY DOCUMENTS FOR EXPORT/IMPORT OF GOODS FROM/INTO INDIA

(a) Mandatory documents required for export of goods from India:

Bill of Lading/ Airway Bill

Commercial Invoice cum Packing List

Shipping Bill/ Bill of Export

- (b) Mandatory documents required for import of goods into India



- (c) For export or import of specific goods or category of goods, which are subject to any restrictions/policy conditions or require NOC or product specific compliances under any statute, the regulatory authority concerned may notify additional documents for purposes of export or import.
- (d) In specific cases of export or import, the regulatory authority concerned may electronically or in writing seek additional documents or information, as deemed necessary to ensure legal compliance.

### PRINCIPLES OF RESTRICTIONS

DGFT may, through a Notification, impose restrictions on export and import, necessary for: -

Protection of public morals

Protection of human, animal or plant life or health

Protection of patents, trademarks and copyrights, and the prevention of deceptive practices

Prevention of use of prison labour

Protection of national treasures of artistic, historic or archaeological value

Conservation of exhaustible natural resources

Protection of trade of fissionable material or material from which they are derived

Prevention of traffic in arms, ammunition and implements of war.

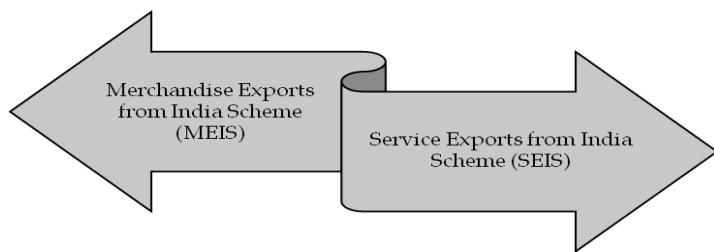
### EXPORT/IMPORT OF RESTRICTED GOODS/SERVICES

Any goods/service, the export or import of which is 'Restricted' may be exported or imported only in accordance with an Authorisation/Permission or in accordance with the procedure prescribed in a Notification/Public Notice issued in this regard.

### EXPORTS FROM INDIA SCHEMES

The objective of the Export from India Schemes is to provide rewards to exporters to offset infrastructural inefficiencies and associated costs involved and to provide exporters a level playing field.

There shall be following two schemes for exports of Merchandise and Services respectively: Two schemes for exports of Merchandise and Services:



### Nature of Rewards

Duty Credit Scrips shall be granted as rewards under MEIS and SEIS. The Duty Credit Scrips and goods imported / domestically procured against them shall be freely transferable.

The Duty Credit Scrips can be used for:

- (i) Payment of Customs Duties for import of inputs or goods, except items listed in Appendix 3A of Appendices and Aayat Niryat Forms of FTP 2015-2020.
- (ii) Payment of excise duties on domestic procurement of inputs or goods, including capital goods as per Department of Revenue (DoR) notification.
- (iii) Payment of service tax on procurement of services as per DoR notification.
- (iv) Payment of Customs Duty and fee as per Foreign Trade Policy.

### Merchandise Exports from India Scheme (MEIS)

The objective of Merchandise Exports from India Scheme (MEIS) is to offset infrastructural inefficiencies and associated costs involved in export of goods/products, which are produced/manufactured in India, especially those having high export intensity, employment potential and thereby enhancing India's export competitiveness.

#### Entitlement under MEIS:

Exports of notified goods/products with ITC [HS] code, to notified markets as listed in Appendix 3B of Appendices and Aayat Niryat Forms of FTP 2015-2020, shall be rewarded under MEIS. Appendix 3B also lists the rate(s) of rewards on various notified products [ITC (HS) code wise]. The basis of calculation of reward would be on realised FOB value of exports in free foreign exchange, or on FOB value of exports as given in the Shipping Bills in free foreign exchange, whichever is less, unless otherwise specified.

#### ***Export of goods through courier or foreign post offices using e-Commerce:***

- (i) Exports of goods through courier or foreign post office using e-commerce, as notified in Appendix 3C of Appendices and Aayat Niryat Forms of FTP 2015-2020, of FOB value upto Rs. 25000 per consignment shall be entitled for rewards under MEIS.
- (ii) If the value of exports using e-commerce platform is more than Rs 25000 per consignment then MEIS reward would be limited to FOB value of Rs.25000 only.
- (iii) Such goods can be exported in manual mode through Foreign Post Offices at New Delhi, Mumbai and Chennai.
- (iv) Export of such goods under Courier Regulations shall be allowed manually on pilot basis through Airports at Delhi, Mumbai and Chennai as per appropriate amendments in regulations to be made by Department of Revenue. Department of Revenue shall fast track the implementation of Electronic Data Interchange (EDI) mode at courier terminals.

## Ineligible categories under MEIS

The following exports categories /sectors shall be ineligible for Duty Credit Scrip entitlement under MEIS:

- (i) EOUs/EHTPs/BTPs/ STPs who are availing direct tax benefits/exemption.
- (ii) Supplies made from DTA units to SEZ units
- (iii) Export of imported goods covered;
- (iv) Exports through trans-shipment, meaning thereby exports that are originating in third country but trans-shipped through India;
- (v) Deemed Exports;
- (vi) SEZ/EOU/EHTP/BPT/FTWZ products exported through DTA units;
- (vii) Items, which are restricted or prohibited for export under Schedule-2 of Export Policy in ITC (HS), unless specifically notified in Appendix 3B.
- (viii) Service Export.
- (ix) Red sanders and beach sand.
- (x) Export products which are subject to Minimum export price or export duty.
- (xi) Diamond Gold, Silver, Platinum, other precious metal in any form including plain and studded jewellery and other precious and semi-precious stones.
- (xii) Ores and concentrates of all types and in all formations.
- (xiii) Cereals of all types.
- (xiv) Sugar of all types and all forms.
- (xv) Crude/petroleum oil and crude/primary and base products of all types and all formulations.
- (xvi) Export of milk and milk products.
- (xvii) Export of Meat and Meat Products.
- (xviii) Products wherein precious metal/diamond are used or Articles which are studded with precious stones.
- (xix) Exports made by units in Free Trade and Warehousing Zone( FTWZ) .

## Service Exports from India Scheme (SEIS)

The objective of Service Exports from India Scheme (SEIS) is to encourage export of notified Services from India.

Eligibility:

- (a) Service Providers of notified services, located in India, shall be rewarded under SEIS, subject to conditions as may be notified. The notified services and rates of rewards are listed in Appendix 3D of Appendices and Aayat Niryat Forms of FTP 2015-2020. Following Services shall be eligible:
  - (i) Supply of a 'service' from India to any other country; (Mode1- Cross border trade)
  - (ii) Supply of a 'service' from India to service consumer(s) of any other country; (Mode 2-Consumption abroad).
- (b) Such service provider should have minimum net free foreign exchange earnings of US\$15,000 in preceding financial year to be eligible for Duty Credit Scrip. For Individual Service Providers and sole proprietorship, such minimum net free foreign exchange earnings criteria would be US\$10,000 in preceding financial year.
- (c) Payment in Indian Rupees for service charges earned on specified services, shall be treated as receipt in deemed foreign exchange as per guidelines of Reserve Bank of India. The list of such services is indicated in Appendix 3E of Appendices and Aayat Niryat Forms of FTP 2015-2020.
- (d) Net Foreign exchange earnings for the scheme are defined as under:

Net Foreign Exchange = Gross Earnings of Foreign Exchange minus Total expenses/payment/ remittances of Foreign Exchange by the IEC holder, relating to service sector in the Financial year.

- (e) If the IEC holder is a manufacturer of goods as well as service provider, then the foreign exchange earnings and Total expenses/payment/remittances shall be taken into account for service sector only.
- (f) In order to claim reward under the scheme, Service provider shall have to have an active IEC at the time of rendering such services for which rewards are claimed.

Ineligible categories under SEIS:

- (1) Foreign exchange remittances other than those earned for rendering of notified services would not be counted for entitlement. Thus, other sources of foreign exchange earnings such as equity or debt participation, donations, receipts of repayment of loans etc. and any other inflow of foreign exchange, unrelated to rendering of service, would be ineligible.
- (2) Following shall not be taken into account for calculation of entitlement under the scheme
  - (a) Foreign Exchange remittances:
    - I. Related to Financial Services Sector
      - (i) Raising of all types of foreign currency Loans;
      - (ii) Export proceeds realization of clients;
      - (iii) Issuance of Foreign Equity through ADRs/GDRs or other similar instruments;
      - (iv) Issuance of foreign currency Bonds;
      - (v) Sale of securities and other financial instruments;
      - (vi) Other receivables not connected with services rendered by financial institutions; and
    - II. Earned through contract/regular employment abroad (e.g. labour remittances);
  - (b) Payments for services received from EEFC Account;
  - (c) Foreign exchange turnover by Healthcare Institutions like equity participation, donations etc.
  - (d) Foreign exchange turnover by Educational Institutions like equity participation, donations etc.
  - (e) Export turnover relating to services of units operating under SEZ/EOU/EHTP/STPI/BTP Schemes or supplies of services made to such units;
  - (f) Clubbing of turnover of services rendered by SEZ/EOU /EHTP/STPI/BTP units with turnover of DTA Service Providers;
  - (g) Exports of Goods.
  - (h) Foreign Exchange earnings for services provided by Airlines, Shipping lines service providers plying from any foreign country X to any foreign country Y routes not touching India at all.
  - (i) Service providers in Telecom Sector.

### **Entitlement under SEIS:**

Service Providers of eligible services shall be entitled to Duty Credit Scrip at notified rates on net foreign exchange earned.

### **STATUS HOLDER**

- (a) Status Holders are business leaders who have excelled in international trade and have successfully contributed to country's foreign trade. Status Holders are expected to not only contribute towards India's exports but also provide guidance and handholding to new entrepreneurs.
- (b) All exporters of goods, services and technology having an import-export code (IEC) number shall be eligible for recognition as a status holder. Status recognition depends upon export performance. An applicant shall be categorized as status holder upon achieving export performance during current and previous two financial years, as indicated in Foreign Trade Policy. The export performance will be counted on the basis of FOB value of export earnings in free foreign exchange.

- (c) For deemed export, FOR value of exports in Indian Rupees shall be converted in US\$ at the exchange rate notified by CBEC, as applicable on 1st April of each Financial Year.
- (d) For granting status, export performance is necessary in at least two out of three years.

### Status Category

| Status Category         | Export Performance                             |
|-------------------------|--|
|                         | FOB/FOR (as converted) Value(in US \$ million) |
| One Star Export House   | 3  |
| Two Star Export House   | 25   |
| Three Star Export House | 100  |
| Four Star Export House  | 500  |
| Five Star Export House  | 2000   |

### Grant of double weightage

- (a) The exports by IEC holders under the following categories shall be granted double weightage for calculation of export performance for grant of status.
  - (i) Micro, Small & Medium Enterprises (MSME) as defined in Micro, Small & Medium Enterprises Development (MSMED) Act 2006.
  - (ii) Manufacturing units having International Organisation for Standardisation (ISO)/Bureau of Indian Standards (BIS).
  - (iii) Units located in North Eastern States including Sikkim and Jammu & Kashmir.
  - (iv) Units located in Agri Export Zones.
- (b) Double Weightage shall be available for grant of One Star Export House Status category only. Such benefit of double weightage shall not be admissible for grant of status recognition of other categories namely Two Star Export House, Three Star Export House, Four Star export House and Five Star Export House.
- (c) A shipment can get double weightage only once in any one of above categories.

### Other conditions for grant of status

- (a) Export performance of one IEC holder shall not be permitted to be transferred to another IEC holder. Hence, calculation of exports performance based on disclaimer shall not be allowed.
- (b) Exports made on re-export basis shall not be counted for recognition.
- (c) Export of items under authorization, including SCOMET items, would be included for calculation of export performance.

### Privileges of Status Holders

A Status Holder shall be eligible for privileges as under:

- (a) Authorisation and Customs Clearances for both imports and exports may be granted on self-declaration basis;
- (b) Input-Output norms may be fixed on priority within 60 days by the Norms Committee;
- (c) Exemption from furnishing of Bank Guarantee for Schemes under FTP, unless specified otherwise anywhere in FTP or Hand Book of Procedure (HBP);
- (d) Exemption from compulsory negotiation of documents through banks. Remittance/receipts, however, would be received through banking channels;

- (e) Two star and above Export houses shall be permitted to establish Export Warehouses as per Department of Revenue guidelines.
- (f) Three Star and above Export House shall be entitled to get benefit of Accredited Clients Programme (ACP) as per the guidelines of CBEC (website: <http://cbec.gov.in>).
- (g) The status holders would be entitled to preferential treatment and priority in handling of their consignments by the concerned agencies.
- (h) Manufacturers who are also status holders (Three Star/Four Star/Five Star) will be enabled to self-certify their manufactured goods (as per their Industrial Entrepreneurial Memorandum (IEM)/ Industrial Licensing (IL)/ Letter of Intent (LOI) as originating from India with a view to qualify for preferential treatment under different preferential trading agreements (PTA), Free Trade Agreements (FTAs), Comprehensive Economic Cooperation Agreements (CECA) and Comprehensive Economic Partnership Agreements (CEPA). Subsequently, the scheme may be extended to remaining Status Holders.
- (i) Manufacturer exporters who are also Status Holders shall be eligible to self-certify their goods as originating from India as per Hand Book of Procedures.
- (j) Status holders shall be entitled to export freely exportable items on free of cost basis for export promotion subject to an annual limit of Rs 10 lakh or 2% of average annual export realization during preceding three licencing years whichever is higher.

## DUTY EXEMPTION/REMISSION SCHEMES

Duty Exemption/Remission Schemes enable duty free import of inputs for export production, including replenishment of input or duty remission.

Schemes:

- (a) Duty Exemption Schemes.

The Duty Exemption schemes consist of the following:

- (i) Advance Authorisation (AA) (which will include Advance Authorisation for Annual Requirement).
- (ii) Duty Free Import Authorisation (DFIA).

- (b) Duty Remission Scheme.

Duty Drawback (DBK) Scheme, administered by Department of Revenue.

## ADVANCE AUTHORISATION

- (a) Advance Authorisation is issued to allow duty free import of input, which is physically incorporated in export product (making normal allowance for wastage). In addition, fuel, oil, catalyst which is consumed/ utilised in the process of production of export product, may also be allowed.
- (b) Advance Authorisation is issued for inputs in relation to resultant product, on the following basis:
  - (i) As per Standard Input Output Norms (SION) notified (available in Hand Book of Procedures); OR
  - (ii) On the basis of self declaration as per Handbook of Procedures.

### Advance Authorisation for Spices

Duty free import of spices covered under Chapter-9 of ITC (HS) shall be permitted only for activities like crushing/ grinding/sterilization/manufacture of oils or oleoresins. Authorisation shall not be available for simply cleaning, grading, re-packing etc.

### Eligible Applicant/Export/Supply

- (a) Advance Authorisation can be issued either to a manufacturer exporter or merchant exporter tied to supporting manufacturer.

- (b) Advance Authorisation for pharmaceutical products manufactured through Non-Infringing (NI) process (as indicated in Handbook of Procedures) shall be issued to manufacturer exporter only.
- (c) Advance Authorisation shall be issued for:
  - (i) Physical export (including export to SEZ);
  - (ii) Intermediate supply; and/or
  - (iii) Supply of goods to the categories mentioned in paragraph 7.02 (b), (c), (e), (f), (g) and (h) of this FTP (Category of Supply under Deemed Exports).
  - (iv) Supply of 'stores' on board of foreign going vessel/aircraft, subject to condition that there is specific Standard Input Output Norms in respect of item supplied.

### Advance Authorisation for Annual Requirement

- (i) Advance Authorisation for Annual Requirement shall only be issued for items notified in Standard Input Output Norms (SION), and it shall not be available in case of adhoc norms under FTP.
- (ii) Advance Authorisation for Annual Requirement shall also not be available in respect of SION where any item of input appears in Appendix 4-J of Appendices and Aayat Niryat Forms of FTP 2015-2020.

### Eligibility Condition to obtain Advance Authorisation for Annual Requirement

- (i) Exporters having past export performance (in at least preceding two financial years) shall be entitled for Advance Authorisation for Annual requirement.
- (ii) Entitlement in terms of CIF value of imports shall be upto 300% of the FOB value of physical export and/ or FOR value of deemed export in preceding financial year or Rs 1 crore, whichever is higher.

### Value Addition

Value Addition for the Duty Exemption/Remission Schemes (except for Gems and Jewellery sector for which value addition is prescribed in FTP) shall be:-

$$VA = \frac{A - B}{B} \times 100, \text{ where}$$

A = FOB value of export realized / FOR value of supply received.

B = CIF value of inputs covered by Authorisation, plus value of any other input used on which benefit of DBK is claimed or intended to be claimed.

### Minimum Value Addition

- (i) Minimum value addition required to be achieved under Advance Authorisation is 15%.
- (ii) Export Products where value addition could be less than 15% are given in Appendix 4D of Appendices and Aayat Niryat Forms of FTP 2015-2020.
- (ii) For physical exports for which payments are not received in freely convertible currency, value addition shall be as specified in Appendix 4C of Appendices and Aayat Niryat Forms of FTP 2015-2020.
- (iv) Minimum value addition for Gems & Jewellery Sector is given in paragraph 4.61 of Handbook of Procedures.
- (v) In case of Tea, minimum value addition shall be 50%.

### Details of Duties exempted

Imports under Advance Authorisation are exempted from payment of Basic Customs Duty, Additional Customs Duty, Education Cess, Anti-dumping Duty, Safeguard Duty and Transition Product Specific Safeguard Duty, wherever applicable. However, Import against supplies covered under certain category of supply under Deemed Exports of

FTP will not be exempted from payment of applicable Anti-dumping Duty, Safeguard Duty and Transition Product Specific Safeguard Duty, if any.

### Admissibility of Drawback

Drawback as per rate determined and fixed by Central Excise authority shall be available for duty paid imported or indigenous inputs (not specified in the norms) used in the export product. For this purpose, applicant shall indicate clearly details of duty paid input in the application for Advance Authorisation. As per details mentioned in the application, Regional Authority shall also clearly endorse details of such duty paid inputs in the condition sheet of the Advance Authorisation.

### Actual User Condition for Advance Authorisation

- (i) Advance Authorisation and/or material imported under Advance Authorisation shall be subject to 'Actual User' condition. The same shall not be transferable even after completion of export obligation. However, Authorisation holder will have option to dispose of product manufactured out of duty free input once export obligation is completed.
- (ii) In case where CENVAT credit facility on input has been availed for the exported goods, even after completion of export obligation, the goods imported against such Advance Authorisation shall be utilized only in the manufacture of dutiable goods whether within the same factory or outside (by a supporting manufacturer). For this, the Authorisation holder shall produce a certificate from either the jurisdictional Central Excise Authority or Chartered Accountant, at the option of the exporter, at the time of filing application for Export Obligation Discharge Certificate to Regional Authority concerned.
- (iii) Waste/scrap arising out of manufacturing process, as allowed, can be disposed off on payment of applicable duty even before fulfillment of export obligation.

### Validity Period for Import

- (i) Validity period for import of Advance Authorisation shall be 12 months from the date of issue of Authorisation.
- (ii) Advance Authorisation for Deemed Export shall be co-terminus with contracted duration of project execution or 12 months from the date of issue of Authorisation, whichever is more.

### Importability/Exportability of items that are Prohibited/Restricted/ State Trading Enterprise(STE)

- (i) No export or import of an item shall be allowed under Advance Authorisation/DFIA if the item is prohibited for exports or imports respectively. Export of a prohibited item may be allowed under Advance Authorisation provided it is separately so notified, subject to the conditions given therein.
- (ii) Items reserved for imports by STEs cannot be imported against Advance Authorisation/DFIA. However those items can be procured from STEs against ARO or Invalidation letter. STEs are also allowed to sell goods on High Sea Sale basis to holders of Advance Authorisation/DFIA holder. STEs are also permitted to issue "No Objection Certificate (NOC)" for import by Advance Authorisation/DFIA holder. Authorisation Holder would be required to file Quarterly Returns of imports effected against such NOC to concerned STE and STE would submit half-yearly import figures of such imports to concerned administrative Department for monitoring with a copy endorsed to DGFT.
- (iii) Items reserved for export by STE can be exported under Advance Authorisation /Duty Free Import Authorisation (DFIA) only after obtaining a 'No Objection Certificate' from the concerned STE.
- (iv) Import of restricted items shall be allowed under Advance Authorisation/ Duty Free Import Authorisation (DFIA).
- (v) Export of restricted/Special Chemicals, Organisms, Materials, Equipment and Technology (SCOMET) items however, shall be subject to all conditionalities or requirements of export authorisation or permission, as may be required, under Schedule 2 of ITC (HS).

### Free of Cost Supply by Foreign Buyer

Advance Authorisation shall also be available where some or all inputs are supplied free of cost to exporter by foreign buyer. In such cases, notional value of free of cost input shall be added in the CIF value of import and FOB

value of export for the purpose of computation of value addition. However, realization of export proceeds will be equivalent to an amount excluding notional value of such input.

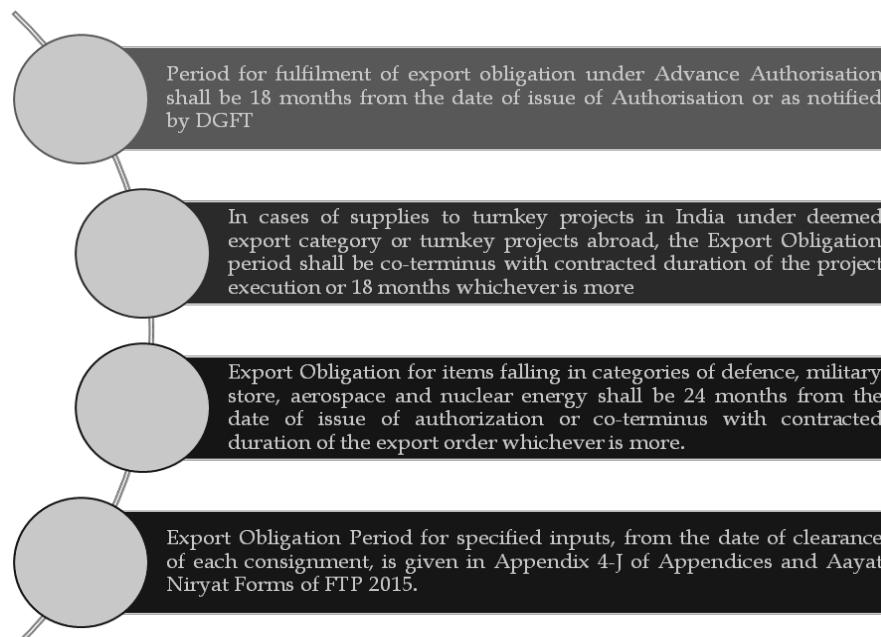
### Domestic Sourcing of Inputs

- (i) Holder of an Advance Authorisation/Duty Free Import Authorisation can procure inputs from indigenous supplier/ State Trading Enterprise in lieu of direct import. Such procurement can be against Advance Release Order (ARO), Invalidation Letter, and Back-to-Back Inland Letter of Credit.
- (ii) When domestic supplier intends to obtain duty free material for inputs through Advance Authorisation for supplying resultant product to another Advance Authorisation/Duty Free Import Authorisation (DFIA)/ Export Promotion Capital Goods (EPCG) Authorisation, Regional Authority shall issue Invalidation Letter.
- (iii) Regional Authority shall issue Advance Release Order if the domestic supplier intends to seek refund of duty through Deemed Exports mechanism of FTP.
- (iv) Regional Authority may issue Advance Release Order or Invalidation Letter at the time of issue of Authorisation simultaneously or subsequently.
- (v) Advance Authorisation holder under Domestic Tariff Area (DTA) can procure inputs from EOU/EHTP/ BTP/ STP/SEZ units without obtaining Advance Release Order or Invalidation Letter.
- (vi) Duty Free Import Authorisation holder shall also be eligible for Advance Release Order/Invalidation Letter facility.
- (vii) Validity of Advance Release Order/Invalidation Letter shall be co-terminous with validity of Authorisation.

### Currency for Realisation of Export Proceeds

- (i) Export proceeds shall be realized in freely convertible currency except otherwise specified.
- (ii) Export to Rupee Payment Area (RPA) (for which payments are not received in freely convertible currency) shall be subject to minimum value addition as specified in Appendix-4C.
- (iii) Export to SEZ Units shall be taken into account for discharge of export obligation provided payment is realised from Foreign Currency Account of the SEZ unit.
- (iv) Export to SEZ Developers/Co-developers can also be taken into account for discharge of export obligation even if payment is realised in Indian Rupees.
- (v) Authorisation holder needs to file Bill of Export for export to SEZ unit/developer/co-developer in accordance with the procedures given in SEZ Rules, 2006.

### Export Obligation



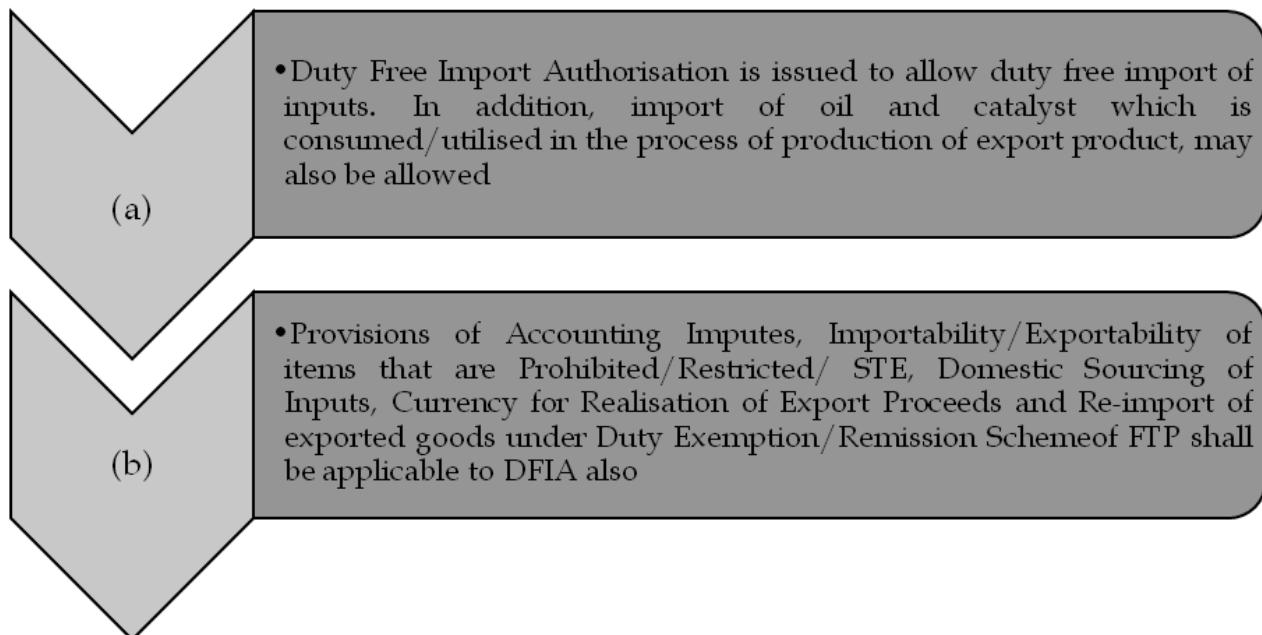
## Export Obligation Period (EOP) Extension for units under Board of Industrial and Financial Reconstruction (BIFR)/ Rehabilitation

A company holding Advance Authorisation and registered with BIFR/Rehabilitation Department of State Government or any firm/company acquiring a unit holding Advance Authorisation which is under BIFR/Rehabilitation, may be permitted export obligation extension for the Advance Authorisation(s) held by the acquired unit, as per rehabilitation package prepared by operating agency and approved by BIFR/Rehabilitation Department of State Government. If time-period upto which Export Obligation (EO) extension is to be granted is not specifically mentioned in the BIFR order, EO extension of two years from the date of expiry of Export Obligation Period( EOP) (including extended period) or the date of BIFR order, whichever is later, shall be granted without payment of composition fee.

## Re-import of exported goods under Duty Exemption/Remission Scheme

Goods exported under Advance Authorisation / Duty Free Import Authorisation may be re-imported in same or substantially same form subject to such conditions as may be specified by Department of Revenue. Authorisation holder shall also inform about such re-importation to the Regional Authority which had issued the Authorisation within one month from date of re-import.

## DUTY FREE IMPORT AUTHORISATION SCHEME (DFIA)



## Duties Exempted and Admissibility of CENVAT and Drawback

- (i) Duty Free Import Authorisation shall be exempted only from payment of Basic Customs Duty.
- (ii) Additional customs duty/excise duty, being not exempt, shall be adjusted as CENVAT credit as per DoR rules.
- (iii) Drawback as per rate determined and fixed by Central Excise authority shall be available for duty paid inputs, whether imported or indigenous, used in the export product. However, in case such drawback is claimed for inputs not specified in SION, the applicant should have indicated clearly details of such duty paid inputs also in the application for Duty Free Import Authorization, and as per the details mentioned in the application, the Regional Authority should also have clearly endorsed details of such duty paid inputs in the condition sheet of the Duty Free Import Authorization.

## ELIGIBILITY

### Eligibility of DFIA



### Minimum Value Addition

Minimum value addition of 20% shall be required to be achieved. For items where higher value addition has been prescribed under Advance Authorisation in Appendix 4C of Appendices and Aayat Niryat Forms of FTP 2015, the same value addition shall be applicable for Duty Free Import Authorisation also.

### Validity & Transferability of DFIA

- (i) Applicant shall file online application to Regional Authority concerned before starting export under DFIA.
- (ii) Export shall be completed within 12 months from the date of online filing of application and generation of file number.
- (iii) While doing export/supply, applicant shall indicate file number on the export documents viz. Shipping Bill/Airway Bill/ Bill of Export/ARE-1/ARE-3, Central Excise certified Invoice.
- (iv) After completion of exports and realization of proceeds, request for issuance of transferable Duty Free Import Authorisation may be made to concerned Regional Authority within a period of twelve months from the date of export or six months (or additional time allowed by RBI for realization) from the date of realization of export proceeds, whichever is later.
- (v) Applicant shall be allowed to file application beyond 24 months from the date of generation of file number as per paragraph 9.03 of Hand Book of Procedures.
- (vi) Separate DFIA shall be issued for each SION and each port.
- (vii) Exports under DFIA shall be made from a single port as mentioned in paragraph 4.37 of Handbook of Procedures.
- (viii) No Duty Free Import Authorisation shall be issued for an export product where SION prescribes 'Actual User' condition for any input.
- (ix) Regional Authority shall issue transferable DFIA with a validity of 12 months from the date of issue. No further revalidation shall be granted by Regional Authority.

## Sensitive Items under Duty Free Import Authorisation

In respect of resultant products requiring following inputs, exporter shall be required to provide declaration with regard to technical characteristics, quality and specification in Shipping Bill:

"Alloy steel including Stainless Steel, Copper Alloy, Synthetic Rubber, Bearings, Solvent, Perfumes/ Essential Oil/ Aromatic Chemicals, Surfactants, Relevant Fabrics, marble, Articles made of polypropylene, Articles made of Paper and Paper Board, Insecticides, Lead Ingots, Zinc Ingots, Citric Acid, Relevant Glass fibre reinforcement (Glass fibre, Chopped/Stranded Mat, Roving Woven Surfacing Mat), Relevant Synthetic Resin (unsaturated polyester resin, Epoxy Resin, Vinyl Ester Resin, Hydroxy Ethyl Cellulose), Lining Material".

While issuing Duty Free Import Authorisation, Regional Authority shall mention technical characteristics, quality and specification in respect of above inputs in the Authorisation.

## SCHEMES FOR EXPORTERS OF GEMS AND JEWELLERY

### Import of Input

Exporters of gems and Jewellery can import/procure duty free input for manufacture of export product.

### Items of Export

Following items, if exported, would be eligible:

- (i) Gold jewellery, including partly processed jewellery and articles including medallions and coins (excluding legal tender coins), whether plain or studded, containing gold of 8 carats and above;
- (ii) Silver jewellery including partly processed jewellery, silverware, silver strips and articles including medallions and coins (excluding legal tender coins and any engineering goods) containing more than 50% silver by weight;
- (iii) Platinum jewellery including partly processed jewellery and articles including medallions and coins (excluding legal tender coins and any engineering goods) containing more than 50% platinum by weight.

### Schemes

- (i) The schemes are as follows:
- (ii) Advance Procurement/Replenishment of Precious Metals from Nominated Agencies;
- (iii) Replenishment Authorisation for Gems;
- (iv) Replenishment Authorisation for Consumables;
- (v) Advance Authorisation for Precious Metals.

### Value Addition

Minimum Value Addition norms for gems and jewellery sector would be calculated as under:

$$VA = \frac{A-B}{B} \times 100, \text{ where}$$

A = FOB value of the export realised/FOR value of supply received.

B = Value of inputs (including domestically procured) such as gold/silver/platinum content in export product plus admissible wastage along with value of other items such as gemstone etc. Wherever gold has been obtained on loan basis, value shall also include interest paid in free foreign exchange to foreign supplier.

### DFIA not available

Duty Free Import Authorisation scheme shall not be available for Gems and Jewellery sector.

## EXPORT PROMOTION CAPITAL GOODS (EPCG) SCHEME

### Objective

The objective of the Export Promotion Capital Goods(EPCG) Scheme is to facilitate import of capital goods for producing quality goods and services to enhance India's export competitiveness.

### EPCG Scheme

- (a) EPCG Scheme allows import of capital goods for pre-production, production and post-production at Zero customs duty. Alternatively, the Authorisation holder may also procure Capital Goods from indigenous sources. Capital goods for the purpose of the EPCG scheme shall include:
  - (i) Capital Goods including in Completely Knocked down (CKD)/ Semi- Knocked Down (SKD) condition thereof;
  - (ii) Computer software systems;
  - (iii) Spares, moulds, dies, jigs, fixtures, tools & refractories for initial lining and spare refractories; and
  - (iv) Catalysts for initial charge plus one subsequent charge.
- (b) Import of capital goods for Project Imports notified by Central Board of Excise and Customs is also permitted under EPCG Scheme.
- (c) Import under EPCG Scheme shall be subject to an export obligation equivalent to 6 times of duty saved on capital goods, to be fulfilled in 6 years reckoned from date of issue of Authorisation.
- (d) Authorisation shall be valid for import for 18 months from the date of issue of Authorisation. Revalidation of EPCG Authorisation shall not be permitted.
- (e) In case countervailing duty (CVD) is paid in cash on imports under EPCG, incidence of CVD would not be taken for computation of net duty saved, provided CENVAT is not availed.
- (f) Second hand capital goods shall not be permitted to be imported under EPCG Scheme.
- (g) Authorisation under EPCG Scheme shall not be issued for import of any Capital Goods (including Captive plants and Power Generator Sets of any kind) for
  - (i) Export of electrical energy (power)
  - (ii) Supply of electrical energy (power) under deemed exports
  - (iii) Use of power (energy) in their own unit, and
  - (iv) Supply/export of electricity transmission services
- (h) Import of items which are restricted for import shall be permitted under EPCG Scheme only after approval from Exim Facilitation Committee (EFC) at DGFT Headquarters.
  - (i) If the goods proposed to be exported under EPCG authorisation are restricted for export, the EPCG authorisation shall be issued only after approval for issuance of export authorisation from Exim Facilitation Committee at DGFT Headquarters.

### Coverage of the Scheme

- (a) EPCG scheme covers manufacturer exporters with or without supporting manufacturer(s), merchant exporters tied to supporting manufacturer(s) and service providers. Name of supporting manufacturer(s) shall be endorsed on the EPCG authorisation before installation of the capital goods in the factory/ premises of the supporting manufacturer (s). In case of any change in supporting manufacturer (s) the RA shall intimate such change to jurisdictional Central Excise Authority of existing as well as changed supporting manufacturer (s) and the Customs at port of registration of Authorisation.
- (b) Export Promotion Capital Goods (EPCG) Scheme also covers a service provider who is designated/ certified as a Common Service Provider (CSP) by the DGFT, Department of Commerce or State Industrial Infrastructure

Corporation in a Town of Export Excellence subject to provisions of Foreign Trade Policy/Handbook of Procedures with the following conditions:-

- (i) Export by users of the common service, to be counted towards fulfilment of EO of the Common Service Provider shall contain the EPCG authorisation details of the Common Service Provider in the respective Shipping bills and concerned RA must be informed about the details of the Users prior to such export;
- (ii) Such export will not count towards fulfilment of specific export obligations in respect of other EPCG authorisations (of the CSP/User);
- (iii) Authorisation holder shall be required to submit Bank Guarantee (BG) which shall be equivalent to the duty saved. BG can be given by Common Service Provider or by any one of the users or a combination thereof, at the option of the Common Service Provider.

### Actual User Condition

Import of capital goods shall be subject to Actual User condition till export obligation is completed.

### Export Obligation (EO)

Following conditions shall apply to the fulfillment of EO:-

- (a) Export Obligation shall be fulfilled by the authorisation holder through export of goods which are manufactured by him or his supporting manufacturer/services rendered by him, for which the EPCG authorisation has been granted.
- (b) Export Obligation under the scheme shall be, over and above, the average level of exports achieved by the applicant in the preceding three licensing years for the same and similar products within the overall EO period including extended period, if any; except for categories mentioned in paragraph 5.13(a) of Hand Book of Procedures (HBP). Such average would be the arithmetic mean of export performance in the preceding three licensing years for same and similar products.
- (c) In case of indigenous sourcing of Capital Goods, specific EO shall be 25% less than the EO stipulated in EPCG scheme.
- (d) Shipments under Advance Authorisation, DFIA, Drawback scheme or reward schemes under FTP; would also count for fulfillment of EO under EPCG Scheme.
- (e) Export shall be physical export. However, deemed exports as specified FTP shall also be counted towards fulfillment of export obligation, alongwith usual benefits available under Actual user condition of EPCG scheme.
- (f) Export Obligation can also be fulfilled by the supply of ITA-I items to DTA, provided realization is in free foreign exchange.
- (g) Royalty payments received by the Authorisation holder in freely convertible currency and foreign exchange received for R&D services shall also be counted for discharge under EPCG.
- (h) Payment received in rupee terms for such Services as notified in Appendix 3E of Appendices and Aayat Niryat Forms of FTP 2015 shall also be counted towards discharge of export obligation under the EPCG scheme.

### Legal Undertaking (LUT)/Bond/ Bank Guarantee (BG)in case of Agro units

Legal Undertaking /Bond or 15% Bank Guarantee, as applicable, may be furnished for EPCG authorisation granted to units in Agri-Export Zones provided EPCG authorisation is taken for export of primary agricultural product(s) notified or their value added variants.

### Indigenous Sourcing of Capital Goods and benefits to Domestic Supplier

A person holding an EPCG authorisation may source capital goods from a domestic manufacturer. Such domestic manufacturer shall be eligible for deemed export benefit under FTP. Such domestic sourcing shall also be permitted from EOU and these supplies shall be counted for purpose of fulfilment of positive Net Foreign Exchange (NFE) by said EOU as provided in FTP.

## Calculation of Export Obligation

In case of direct imports, Export Obligation shall be reckoned with reference to actual duty saved amount. In case of domestic sourcing, Export Obligation shall be reckoned with reference to notional Customs duties saved on FOR value.

## Incentive for early EO fulfilment

With a view to accelerating exports, in cases where Authorisation holder has fulfilled 75% or more of specific export obligation and 100% of Average Export Obligation till date, if any, in half or less than half the original export obligation period specified, remaining export obligation shall be condoned and the Authorisation redeemed by Regional Authority(RA) concerned. However no benefit under Hand Book of Procedure (HBP) shall be permitted where incentive for early EO fulfilment has been availed.

## Reduced Export Obligation for Green Technology Products

For exporters of Green Technology Products, Specific Export Obligation shall be 75% of Export Obligation. The list of Green Technology Products is given in Para 5.29 of Hand Book of Procedure (HBP).

## Reduced Export Obligation for North East Region and Jammu & Kashmir

For units located in Arunachal Pradesh, Assam, Manipur, Meghalaya, Mizoram, Nagaland, Sikkim, Tripura and Jammu & Kashmir, specific Export Obligation shall be 25% of the Export Obligation.

## Post Export EPCG Duty Credit Scrip(s)

- (a) Post Export EPCG Duty Credit Scrip(s) shall be available to exporters who intend to import capital goods on full payment of applicable duties in cash and choose to opt for this scheme.
- (b) Basic Customs duty paid on Capital Goods shall be remitted in the form of freely transferable duty credit scrip(s).
- (c) Specific Export Obligation shall be 85% of the applicable specific EO under the EPCG Scheme. However, average Export Obligation shall remain unchanged.
- (d) Duty remission shall be in proportion to the EO fulfilled.
- (e) All provisions for utilization of scrips issued under FTP shall also be applicable to Post Export EPCG Duty Credit Scrip (s).
- (f) All provisions of the existing EPCG Scheme shall apply insofar as they are not inconsistent with this scheme.

## EXPORT ORIENTED UNITS (EOUs), ELECTRONICS HARDWARE TECHNOLOGY PARKS (EHTPs), SOFTWARE TECHNOLOGY PARKS (STPs) AND BIO-TECHNOLOGY PARKS (BTPs)

### Introduction and Objective

- (a) Units undertaking to export their entire production of goods and services (except permissible sales in DTA), may be set up under the Export Oriented Unit (EOU) Scheme, Electronics Hardware Technology Park (EHTP) Scheme, Software Technology Park (STP) Scheme or Bio-Technology Park (BTP) Scheme for manufacture of goods, including repair, re-making, reconditioning, re-engineering, rendering of services, development of software, agriculture including agro-processing, aquaculture, animal husbandry, bio-technology, floriculture, horticulture, pisciculture, viticulture, poultry and sericulture. Trading units are not covered under these schemes.
- (b) Objectives of these schemes are to promote exports, enhance foreign exchange earnings, attract investment for export production and employment generation.

## Export and Import of Goods

- (a) An EOU/EHTP/STP/BTP unit may export all kinds of goods and services except items that are prohibited in ITC (HS).
- (b) Export of Special Chemicals, Organisms, Materials, Equipment and Technologies (SCOMET) shall be subject to fulfilment of the conditions indicated in ITC (HS). In respect of an EOU, permission to export a prohibited item may be considered, by Board of Approval (BOA), on a case to case basis, provided such raw materials are imported and there is no procurement of such raw material from Domestic Tariff Area (DTA).
- (c) Procurement and supply of export promotion material like brochure/literature, pamphlets, hoardings, catalogues, posters etc up to a maximum value limit of 1.5% of FOB value of previous years exports shall also be allowed.
- (d) An EOU/EHTP/STP/BTP unit may import and/or procure, from Domestic Tariff Area or bonded warehouses in Domestic Tariff Area/international exhibition held in India, without payment of duty, all types of goods, including capital goods, required for its activities, provided they are not prohibited items of import in the ITC (HS). Any permission required for import under any other law shall be applicable. Units shall also be permitted to import goods including capital goods required for approved activity, free of cost or on loan/lease from clients. Import of capital goods will be on a self-certification basis. Goods imported by a unit shall be with actual user condition and shall be utilized for export production.
- (e) State Trading regime shall not apply to EOU manufacturing units. However, in respect of Chrome Ore/Chrome concentrate, State Trading Regime as stipulated in export policy of these items, will be applicable to EOUs.
- (f) EOU/EHTP/STP/BTP units may import/procure from Domestic Tariff Area, without payment of duty, certain specified goods for creating a central facility. Software EOU/DTA units may use such facility for export of software.
- (g) An EOU engaged in agriculture, animal husbandry, aquaculture, floriculture, horticulture, pisciculture, viticulture, poultry or sericulture may be permitted to remove specified goods in connection with its activities for use outside bonded area.
- (h) Gems and jewellery EOUs may source gold/silver/platinum through nominated agencies on loan/ outright purchase basis. Units obtaining gold/silver/platinum from nominated agencies, either on loan basis or outright purchase basis shall export gold/silver/platinum within 90 days from date of release.
- (i) EOU/EHTP/STP/BTP units, other than service units, may export to Russian Federation in Indian Rupees against repayment of State Credit/ Escrow Rupee Account of buyer subject to RBI clearance, if any.
- (j) Procurement and export of spares/components, upto 5% of FOB value of exports, may be allowed to same consignee/buyer of the export article, subject to the condition that it shall not count for Net Foreign Exchange (NFE) and direct tax benefits.
- (k) BOA may allow, on a case to case basis, requests of EOU/EHTP/STP/ BTP units in sectors other than Gems & Jewellery, for consolidation of goods related to manufactured articles and export thereof along with manufactured article. Such goods may be allowed to be imported/procured from DTA by EOU without payment of duty, to the extent of 5% FOB value of such manufactured articles exported by the unit in preceding financial year. Details of procured/imported goods and articles manufactured by the EOU will be listed separately in the export documents. In such cases, value of procured/imported goods will not be taken into account for calculation of NFE and DTA sale entitlement. Such procured/imported goods shall not be allowed to be sold in DTA. BOA may also specify any other conditions.

## Second hand Capital goods

Second hand capital goods, without any age limit, may also be imported duty free.

## Leasing of Capital Goods

- (a) An EOU/EHTP/STP/BTP unit may, on the basis of a firm contract between parties, source capital goods from a domestic/foreign leasing company without payment of customs/excise duty. In such a case, EOU/EHTP/

STP/BTP unit and domestic/foreign leasing company shall jointly file documents to enable import/procurement of capital goods without payment of duty.

- (b) An EOU/EHTP/BTP/STP unit may sell capital goods and lease back the same from a Non Banking Financial Company (NBFC), subject to the following conditions:
- (i) The unit should obtain permission from the jurisdictional Deputy/Assistant Commissioner of Customs or Central Excise, for entering into transaction of 'Sale and Lease Back of Assets', and submit full details of the goods to be sold and leased back and the details of NBFC;
  - (ii) The goods sold and leased back shall not be removed from the unit's premises;
  - (iii) The unit should be NFE positive at the time when it enters into sale and lease back transaction with NBFC;
  - (iv) A joint undertaking by the unit and NBFC should be given to pay duty on goods in case of violation or contravention of any provision of the notification under which these goods were imported or procured, read with Customs Act, 1962 or Central Excise Act, 1944, and that the lien on the goods shall remain with the Customs/Central Excise Department, which will have first charge over the said goods for recovery of sum due from the unit to Government under provision of Section 142(b) of the Customs Act, 1962 read with the Customs (Attachment of Property of Defaulters for Recovery of Govt. Dues) Rules, 1995.

### Net Foreign Exchange Earnings

EOU/EHTP/STP/BTP unit shall be a positive net foreign exchange earner except for sector specific provision of Appendix 6 B of Appendices & ANFs, where a higher value addition shall be required. Net Foreign Exchange (NFE) Earnings shall be calculated cumulatively in blocks of five years, starting from commencement of production. Whenever a unit is unable to achieve NFE due to prohibition/restriction imposed on export of any product mentioned in Letter of Permit (LoP), the five year block period for calculation of Net Foreign Exchange (NFE) earnings may be suitably extended by Board of Approval. Further, wherever a unit is unable to achieve NFE due to adverse market condition or any grounds of genuine hardship having adverse impact on functioning of the unit, the five year block period for calculation of NFE earnings may be extended by Board of Approval for a period of upto one year, on a case to case basis.

### Letter of Permission/Letter of Intent and Legal Undertaking

- (a) On approval, a Letter of Permission (LoP)/Letter of Intent (LoI) shall be issued by DC/designated officer to EOU/ EHTP/STP/BTP unit. LoP/LoI shall have an initial validity of 2 years to enable the Unit to construct the plant & install the machinery and by this time the unit should have commenced production. In case the unit is not able to commence production in initial validity of 2 years, an extension of one year may be given by the DC for valid reasons to be recorded in writing. Subsequent extension of one year may be given by the Unit Approval Committee subject to condition that two-thirds of activities including construction, relating to the setting up of the Unit are complete and Chartered Engineer's certificate to this effect is submitted by the Unit. Further extension, if necessary, will be granted by the Board of Approval. Once unit commences production, LoP/LoI issued shall be valid for a period of 5 years for its activities. This period may be extended further by DC for a period of 5 years at a time.
- (b) LoP/LoI issued to EOU/EHTP/STP/BTP units by concerned authority, subject to compliance of provision pertaining to export and import of goods under EOU/EHTP/STP/BTP Scheme above, would be construed as an Authorisation for all purposes.
- (c) Unit shall execute an LUT with DC concerned. Failure to ensure positive NFE or to abide by any of the terms and conditions of LoP/LoI/IL/LUT shall render the unit liable to penal action under provisions of the FT (D&R) Act, as amended, and Rules and Orders made thereunder, without prejudice to action under any other law/rules and cancellation or revocation of LoP/LoI/IL.

### Investment Criteria

Only projects having a minimum investment of Rs. 1 Crore in plant & machinery shall be considered for establishment as EOUs. However, this shall not apply to existing units, units in EHTP/STP/BTP, and EOUs in Handicrafts/Agriculture/Floriculture/Aquaculture/Animal Husbandry/Information Technology, Services, Brass Hardware and Handmade Jewellery sectors. BOA may allow establishment of EOUs with a lower investment criteria.

## Applications & Approvals

- (a) Applications for setting up of units under EOU scheme shall be approved or rejected by the Units Approval Committee within 15 days as per criteria indicated in Handbook of Procedures (HBP).
- (b) In other cases, approval may be granted by BOA set up for this purpose as indicated in HBP.
- (c) Proposals for setting up EOU requiring industrial licence may be granted approval by DC after clearance of proposal by BOA and Department of Industrial Policy & Promotion( DIPP) within 45 days.
- (d) Applications for conversion into an EOU/EHTP/STP/BTP unit from existing DTA units, having an investment of Rs. 50 crores and above in plant and machinery or exporting Rs. 50 crores and above annually, shall be placed before BOA for a decision.

## DTA Sale of Finished Products/Rejects/Waste/ Scrap/Remnants and By-products

Entire production of EOU/EHTP/STP/BTP units shall be exported subject to following:

- (a) Units, other than gems and jewellery units, may sell goods upto 50% of FOB value of exports, subject to fulfilment of positive NFE, on payment of concessional duties. Within entitlement of DTA sale, unit may sell in DTA, its products similar to goods which are exported or expected to be exported from units.

However, units which are manufacturing and exporting more than one product can sell any of these products into DTA, upto 90% of FOB value of export of the specific products, subject to the condition that total DTA sale does not exceed the overall entitlement of 50% of FOB value of exports for the unit, as stipulated above. No DTA sale at concessional duty shall be permissible in respect of motor cars, alcoholic liquors, books, tea (except instant tea), pepper & pepper products, marble and such other items as may be notified from time to time. Such DTA sale shall also not be permissible to units engaged in activities of packaging/ labelling/ segregation/ refrigeration/ compacting/ micronisation/ pulverization/ granulation/ conversion of monohydrate form of chemical to anhydrous form or vice- versa.

Sales made to a unit in SEZ shall also be taken into account for purpose of arriving at FOB value of export by EOU provided payment for such sales are made from Foreign Currency Account of SEZ unit. Sale to DTA would also be subject to mandatory requirement of registration of pharmaceutical products (including bulk drugs). An amount equal to Anti Dumping duty under section 9A of the Customs Tariff Act, 1975 leviable at the time of import, shall be payable on the goods used for the purpose of manufacture or processing of the goods cleared into DTA from the unit.

- (b) For services, including software units, sale in DTA in any mode, including on line data communication, shall also be permissible up to 50% of FOB value of exports and /or 50% of foreign exchange earned, where payment of such services is received in foreign exchange.
- (c) Gems and jewellery units may sell upto 10% of FOB value of exports of the preceding year in DTA, subject to fulfilment of positive NFE. In respect of sale of plain jewellery, recipient shall pay concessional rate of duty as applicable to sale from nominated agencies. In respect of studded jewellery, duty shall be payable as applicable.
- (d) Unless specifically prohibited in LoP, rejects within an overall limit of 50% may be sold in DTA on payment of duties as applicable to sale under Sub - para 6.08 (a) on prior intimation to Customs authorities. Such sales shall be counted against DTA sale entitlement. Sale of rejects upto 5% of FOB value of exports shall not be subject to achievement of NFE.
- (e) Scrap/waste/remnants arising out of production process or in connection therewith may be sold in DTA, as per SION notified under Duty Exemption Scheme, on payment of concessional duties as applicable, within overall ceiling of 50% of FOB value of exports. Such sales of scrap/waste/remnants shall not be subject to achievement of positive NFE. In respect of items not covered by norms, DC may fix ad- hoc norms for a period of six months and within this period, norms should be fixed by Norms Committee. Ad-hoc norms will continue till such time norms are fixed by Norms Committee. Sale of waste/scrap/ remnants by units not entitled to DTA sale, or sales beyond DTA sale entitlement, shall be on payment of full duties. Scrap/waste/remnants may also be exported.

- (f) There shall be no duties/taxes on scrap/waste/remnents, in case same are destroyed with permission of Customs authorities.
- (g) By-products included in LoP may also be sold in DTA subject to achievement of positive NFE, on payment of applicable duties, within the overall entitlement of Sub - para 6.08 (a). Sale of by-products by units not entitled to DTA sales, or beyond entitlements of Sub-para 6.08 (a), shall also be permissible on payment of full duties.
- (h) EOU/EHTP/STP/BTP units may sell finished products, except pepper and pepper products and marble, which are freely importable under FTP in DTA, under intimation to DC, against payment of full duties, provided they have achieved positive NFE. An amount equal to Anti Dumping duty under section 9A of the Customs Tariff Act, 1975 leviable at the time of import, shall be payable on the goods used for the purpose of manufacture or processing of the goods cleared into DTA from the unit.
- (i) In case of units manufacturing electronics hardware and software, NFE and DTA sale entitlement shall be reckoned separately for hardware and software.
- (j) In case of DTA sale of goods manufactured by EOU/EHTP/STP/BTP, where basic duty and CVD is nil, such goods may be considered as non-excisable for payment of duty.
- (k) In case of new EOUs, advance DTA sale will be allowed not exceeding 50% of its estimated exports for first year, except pharmaceutical units where this will be based on its estimated exports for first two years.
- (l) Units in Textile and Granite sectors shall have an option to sell goods into DTA , on payment of an amount equal to aggregate of duties of excise leviable under section 3 of the Central Excise Act, 1944 or under any other law for the time being in force, on like goods produced or manufactured in India other than in an EOU, subject to the condition that they have not used duty paid imported inputs in excess of 3% of the FOB value of exports of the preceding year and they have achieved positive NFE. Once this option is exercised, the unit will not be allowed to import any duty free inputs for any purpose.
- (m) Procurement of spares/components, up to 2% of the value of manufactured articles, cleared into DTA, during the preceding year, may be allowed for supply to the same consignee/buyer for the purpose of after-sale-service. The same can be cleared in DTA on payment of applicable duty but such clearances shall be within the overall entitlement of the unit for DTA sale at concessional rate of duty as prescribed under DTA Sale of Finished Products/Rejects/Waste/ Scrap/Remnents and By-products of EOU/EHTP/ STP/BTP Scheme.

### Other Supplies

Following supplies effected from EOU/EHTP/STP/BTP units will be counted for fulfilment of positive NFE. Such supplies shall not include "marble", except if such supply of marble is an inter unit supply as provided at Sub - para (c) below:

- (a) Supplies effected in DTA to holders of Advance Authorisation/Advance Authorisation for annual requirement/ DFIA under duty exemption/remission scheme/EPCG scheme. However, printing sector EOUs (or any other sector that may be notified in HBP), can't supply goods, where basic customs duty and CVD is nil or exempted otherwise, to holders of Advance Authorisation/Advance Authorization for annual requirement.
- (b) Supplies affected in DTA against foreign exchange remittance received from overseas.
- (c) Supplies to other EOU/EHTP/STP/BTP/SEZ units, provided that such goods are permissible for procurement in terms of Export and Imports of Goods under EOU/EHTP/STP/BTP Scheme of FTP.
- (d) Supplies made to bonded warehouses set up under FTP and/or under section 65 of Customs Act and free trade and warehousing zones, where payment is received in foreign exchange.
- (e) Supplies of goods and services to such organizations which are entitled for duty free import of such items in terms of general exemption notification issued by MoF, as may be provided in HBP.
- (f) Supplies of Information Technology Agreement (ITA-1) items and notified zero duty telecom/electronics items.
- (g) Supplies of items like tags, labels, printed bags, stickers, belts, buttons or hangers to DTA unit for export.
- (h) Supply of LPG produced in an EOU refinery to Public Sector domestic oil companies for being supplied to household domestic consumers at subsidized prices under the Public Distribution System (PDS) Kerosene

and Domestic LPG Subsidy Scheme, 2002, as notified by the Ministry of Petroleum and Natural Gas vide notification No. E-20029/18/2001-PP dated 28.01.2003 (hereinafter referred to as PDS Scheme) subject to the following conditions:-

- (i) Only supply of such quantity of LPG would be eligible for which Ministry of Petroleum and Natural Gas declines permission for export and requires the LPG to be cleared in DTA; and
- (ii) The Ministry of Finance by a notification has permitted duty free imports of LPG for supply under the aforesaid PDS Scheme.

### Export through others

An EOU/EHTP/STP/BTP unit may export goods manufactured/software developed by it through another exporter or any other EOU/EHTP/STP/SEZ unit subject to conditions mentioned in Para 6.19 of Hand Book of Procedure.

### Entitlement for Supplies from the DTA

- (a) Supplies from DTA to EOU/EHTP/STP/BTP units will be regarded as "deemed exports" and DTA supplier shall be eligible for relevant entitlements under chapter 7 of FTP, besides discharge of export obligation, if any, on the supplier. Notwithstanding the above, EOU/EHTP/STP/BTP units shall, on production of a suitable disclaimer from DTA supplier, be eligible for obtaining entitlements specified in chapter 7 of FTP. For claiming deemed export duty drawback, they shall get brand rates fixed by DC wherever All Industry Rates of Drawback are not available.
- (b) Suppliers of precious and semi-precious stones, synthetic stones and processed pearls from DTA to EOU shall be eligible for grant of Replenishment Authorisations at rates and for items mentioned in HBP.
- (c) In addition, EOU/EHTP/STP/BTP units shall be entitled to following:
  - (i) Reimbursement of Central Sales Tax (CST) on goods manufactured in India. Simple interest @ 6% per annum will be payable on delay in refund of CST, if the case is not settled within 30 days of receipt of complete application (as in Para 9.10 (b) of HBP).
  - (ii) Exemption from payment of Central Excise Duty on goods procured from DTA on goods manufactured in India.
  - (iii) Reimbursement of duty paid on fuel procured from Domestic Oil Companies/Depots of Domestic Oil Public Sector Undertakings as per drawback rate notified by DGFT from time to time. Reimbursement of additional duty of excise levied on fuel under the Finance Acts would also be admissible.
  - (iv) CENVAT Credit on service tax paid.

### Other Entitlements

Other entitlements of EOU/EHTP/STP/BTP units are as under:

- (a) Exemption from industrial licensing for manufacture of items reserved for SSI sector.
- (b) Export proceeds will be realized within nine months.
- (c) Units will be allowed to retain 100% of its export earnings in the EEFC account.
- (d) Unit will not be required to furnish bank guarantee at the time of import or going for job work in DTA, where:
  - (i) the unit has turnover of Rs. 5 crore or above;
  - (ii) the unit is in existence for at least three years; and
  - (iii) the unit:
    - (1) has achieved positive NFE/export obligation wherever applicable;
    - (2) has not been issued a show cause notice or a confirmed demand, during the preceding 3 years, on grounds other than procedural violations, under the penal provision of the Customs Act, the Central Excise Act, the Foreign Trade (Development & Regulation) Act, the Foreign Exchange Management Act, the Finance Act, 1994 covering Service Tax or any allied Acts or the rules made

thereunder, on account of fraud/collusion/wilful mis-statement/ suppression of facts or contravention of any of the provisions thereof;

- (e) 100% FDI investment permitted through automatic route similar to SEZ units.
- (f) Units shall pay duty on the goods produced or manufactured and cleared into DTA on monthly basis in the manner prescribed in the Central Excise Rules.
- (g) The Units Approval Committee may consider on a case-to-case basis request for sharing of infrastructural facilities among EOUs and it shall forward its recommendation to the Board of Approval for its consideration. While accepting such proposals, the NFE obligations of the Units shall not be altered. Such facilities will be available to Units in EHTP/STP after getting approval from IMSC. However, sharing of facilities between EOUs and SEZ Units shall not be permitted.

### Inter Unit Transfer

- (a) Transfer of manufactured goods from one EOU/EHTP/STP/BTP unit to another EOU/EHTP/STP/BTP unit is allowed with prior intimation to concerned Development Commissioners of the transferor and transferee units as well as concerned Customs authorities, following procedure of in-bond movement of goods. Transfer of manufactured goods shall also be allowed from EOU/EHTP/STP/BTP unit to a SEZ developer or unit as per procedure prescribed in SEZ Rules, 2006.
- (b) Capital goods may be transferred or given on loan to other EOU/EHTP/STP/BTP/SEZ units, with prior intimation to concerned DC and Customs authorities. Such transferred goods may also be returned by the second unit to the original unit in case of rejection or for any reason without payment of duty.
- (c) Goods supplied by one unit of EOU/EHTP/STP/BTP to another unit shall be treated as imported goods for second unit for payment of duty, on DTA sale by second unit.
- (d) In respect of a group of EOUs/EHTPs/STPs/BTP Units which source inputs centrally in order to obtain bulk discount and/or reduce cost of transportation and other logistics cost and/or to maintain effective supply chain, inter unit transfer of goods and services may be permitted on a case-to- case basis by the Unit Approval Committee. In case inputs so sourced are imported and then transferred to another unit, then value of the goods so transferred shall be taken as inflow for the unit transferring these goods and as outflow for the unit receiving these goods, for the purpose of calculation of NFE.

### Sub-Contracting

- (a) (i) EOU/EHTP/STP/BTP units, including gems and jewellery units, may on the basis of annual permission from Customs authorities, sub - contract production processes to DTA through job work which may also involve change of form or nature of goods, through job work by units in DTA.  
 (ii) These units may sub - contract upto 50% of overall production of previous year in value terms in DTA with permission of Customs authorities.
- (b) (i) EOU may, with annual permission from Customs authorities, undertake job work for export, on behalf of DTA exporter, provided that goods are exported directly from EOU and export document shall jointly be in name of DTA/EOU. For such exports, DTA units will be entitled for refund of duty paid on inputs by way of brand rate of duty drawback.

Duty free import of goods for execution of export order placed on EOU by foreign supplier on job work basis, would be allowed subject to condition that no DTA clearance shall be allowed.

Sub-contracting of both production and production processes may also be undertaken without any limit through other EOU/EHTP/STP/ BTP/SEZ units, on the basis of records maintained in unit.

EOU/EHTP/STP/BTP units may sub - contract part of production process abroad and send intermediate products abroad as mentioned in LoP. No permission would be required when goods are sought to be exported from sub - contractor premises abroad. When goods are sought to be brought back, prior intimation to concerned DC and Customs authorities shall be given.

- (c) Scrap/waste/remnants generated through job work may either be cleared from job worker's premises on payment of applicable duty on transaction value or destroyed in presence of Customs/Central Excise authorities or returned to unit. Destruction shall not apply to gold, silver, platinum, diamond, precious and semi-precious stones.
- (d) Sub - contracting/exchange by gems and jewellery EOUs through other EOUs or SEZ units or units in DTA, shall be as per procedure indicated in Hand Book of Procedure.

### **Sale of Unutilized Material**

- (a) In case an EOU/EHTP/STP/BTP unit is unable to utilize goods and services, imported or procured from DTA, it may be:
  - (i) Transferred to another EOU/EHTP/STP/BTP/SEZ unit; or
  - (ii) Disposed of in DTA with approval of Customs authorities on payment of applicable duties and submission of import authorization; or
  - (iii) Exported.
 Such transfer from EOU/EHTP/STP/BTP unit to another such unit would be treated as import for receiving unit.
- (b) Capital goods and spares that have become obsolete/surplus, may either be exported, transferred to another EOU/EHTP/STP/BTP/SEZ unit or disposed of in DTA on payment of applicable duties. Benefit of depreciation, as applicable, will be available in case of disposal in DTA only when the unit has achieved positive NFE taking into consideration the depreciation allowed. No duty shall be payable in case capital goods, raw material, consumables, spares, goods manufactured, processed or packaged, and scrap/waste/remnants/rejects are destroyed within unit after intimation to Customs authorities or destroyed outside unit with permission of Customs authorities. Destruction as stated above shall not apply to gold, silver, platinum, diamond, precious and semi-precious stones.
- (c) In case of textile sector, disposal of left over material/fabrics upto 2% of CIF value or quantity of import, whichever is lower, on payment of duty on transaction value, may be allowed, subject to certification of Central Excise/Customs officers that these are leftover items.
- (d) Disposal of used packing material will be allowed on payment of duty on transaction value.

### **Reconditioning/Repair and Re-engineering**

- (a) EOUs shall be set up with approval of UAC to carry out reconditioning, repair, remaking, testing, calibration, quality improvement, upgradation of technology and re-engineering activities for export in foreign currency.
- (b) EHTP/STP/BTP units shall be set up with approval of IMSC to carry out reconditioning, repair, remaking, testing, calibration, quality improvement, upgradation of technology and re-engineering activities for export in foreign currency.

### **Replacement/Repair of Imported/Indigenous Goods**

- (a) General provisions of FTP relating to export/import of replacement/repair of goods would also apply equally to EOU/EHTP/STP/BTP units. Cases not covered by these provisions shall be considered on merits by Development Commissioner (DC).
- (b) Goods sold in DTA and not accepted for any reasons, may be brought back for repair/replacement, under intimation to concerned jurisdictional Customs/Central Excise authorities.
- (c) Goods or parts thereof, on being imported/indigenously procured and found defective or otherwise unfit for use or which have been damaged or become defective subsequently, may be returned and replacement obtained or destroyed. In the event of replacement, goods may be brought back from foreign suppliers or their authorized agents in India or indigenous suppliers. The unit can take free of cost replacement (duty paid) from the authorized agents in India of foreign suppliers, provided the defective part is re - exported or destroyed. However, destruction shall not apply to precious and semi- precious stones and precious metals.

## Exit from EOU Scheme

- (a) With approval of Development Commissioner, an EOU may opt out of scheme. Such exit shall be subject to payment of Excise and Customs duties and industrial policy in force.
- (b) If unit has not achieved obligations, it shall also be liable to penalty at the time of exit.
- (c) In the event of a gems and jewellery unit ceasing its operation, gold and other precious metals, alloys, gems and other materials available for manufacture of jewellery, shall be handed over to an agency nominated by Department of Commerce (DoC), at price to be determined by that agency.
- (d) An EOU/EHTP/STP/BTP unit may also be permitted by Development Commissioner to exit from the scheme at any time on payment of duty on capital goods under the prevailing EPCG Scheme for DTA Units. This will be subject to fulfilment of positive NFE criteria under EOU scheme, eligibility criteria under EPCG scheme and standard conditions indicated in Hand Book of Procedure.
- (e) Unit proposing to exit out of EOU scheme shall intimate DC and Customs and Central Excise authorities in writing. Unit shall assess duty liability arising out of de-bonding and submit details of such assessment to Customs and Central Excise authorities. Customs and Central Excise authorities shall confirm duty liabilities on priority basis, subject to the condition that the unit has achieved positive NFE, taking into consideration the depreciation allowed. After payment of duty and clearance of all dues, unit shall obtain "No Dues Certificate" from Customs and Central Excise authorities.

On the basis of "No Dues Certificate" so issued by the Customs and Central Excise authorities, unit shall apply to Development Commissioner for final de-bonding. In case there is no proceeding pending under FT(D&R) Act, as amended, Development Commissioner shall issue final de-bonding order within a period of 7 working days. Between "No Dues Certificate" issued by Customs and Central Excise authorities and final de-bonding order by DC, unit shall not be entitled to claim any exemption for procurement of capital goods or inputs. However, unit can claim Advance Authorisation/DFIA/ Duty Drawback. Since the duty calculations and dues are disputed and take a long time, a BG/Bond/ Instalment processes backed by BG shall be provided for expediting the exit process.

- (f) In cases where a unit is initially established as DTA unit with machines procured from abroad after payment of applicable import duty, or from domestic market after payment of excise duty, and unit is subsequently converted to EOU, in such cases removal of such capital goods to DTA after de-bonding would be without payment of duty. Similarly, in cases where a DTA unit imported capital goods under EPCG Scheme and after completely fulfilling export obligation gets converted into EOU, unit would not be charged customs duty on capital goods at the time of removal of such capital goods in DTA when de-bonding.
- (g) An EOU/EHTP/STP/BTP unit may also be permitted by DC to exit under Advance Authorization as one time option. This will be subject to fulfilment of positive NFE criteria.
- (h) A simplified procedure may be provided to fast track the De-bonding/ Exit of the STP/EHTP Unit which has not availed any duty benefit on procurement of raw material, capital goods etc.

## Conversion

- (a) Existing DTA units may also apply for conversion into an EOU/EHTP/STP/BTP unit.
- (b) Existing EHTP/STP units may also apply for conversion/merger to EOU unit and vice-versa. In such cases, units will remain in bond and avail exemptions in duties and taxes as applicable.

## Monitoring of NFE

Performance of EOU/EHTP/STP/BTP units shall be monitored by Units Approval Committee as per guidelines in HBP.

## Export through Exhibitions/Export Promotion Tours>Showrooms Abroad/Duty Free Shops

EOU/EHTP/STP/BTP are permitted to:



## Personal Carriage of Import/Export Parcels including through Foreign Bound Passengers

Import/export through personal carriage of gems and jewellery items may be undertaken as per Customs procedure. However, export proceeds shall be realized through normal banking channel. Import/export through personal carriage by units, other than gems and jewellery units, shall be allowed provided goods are not in commercial quantity. An authorized person of Gems & Jewellery EOU may also import gold in primary form, upto 10 Kgs in a financial year through personal carriage, as per guidelines prescribed by Reserve Bank Of India and Department of Revenue.

### Export/Import by Post/Courier

Goods including free samples, may be exported/imported by air freight or through foreign post office or through courier, as per Customs procedure.

### Revival of Sick Units

Subject to a unit being declared sick by appropriate authority, proposals for revival of the unit or its take over may be considered by Board of Approval.

### Approval of EHTP/STP

In case of units under EHTP/STP schemes, necessary approval/permission under relevant paras of this Chapter shall be granted by officer designated by Ministry of Communication and Information Technology, Department of Electronics & Information Technology, instead of Development Commissioner, and by Inter-Ministerial Standing Committee (IMSC) instead of Board of Approval.

### Approval of BTP

Bio-Technology Parks (BTP) would be notified by DGFT on recommendations of Department of Biotechnology. In case of units in BTP, necessary approval/permission under relevant provisions of this chapter will be granted by designated officer of Department of Biotechnology.

### Warehousing Facilities

An EOU which intends to set up warehousing facilities outside the EOU premises and outside the jurisdiction of Development Commissioner, at a place near to the port of export, to reduce lead time for delivery of goods overseas

and to address unpredictability of supply orders, is permitted to do so subject to the provisions related to export warehousing as per terms and conditions of Notifications issued by the Department of Revenue.

## QUALITY COMPLAINTS AND TRADE DISPUTES

### Objective

Exporters need to project a good image of the country abroad to promote exports. Maintaining an enduring relationship with foreign buyers is of utmost importance, and complaints or trade disputes, whenever they arise, need to be settled amicably as soon as possible. Importers too may have grievances as well.

In an endeavour to resolve such complaints or trade disputes and to create confidence in the business environment of the country, a mechanism is being laid down to address such complaints and disputes in an amicable way.

### Quality Complaints/ Trade Disputes

The following type of complaints may be considered:

Complaints received from foreign buyers in respect of poor quality of the products supplied by exporters from India

Complaints of importers against foreign suppliers in respect of quality of the products supplied

Complaints of unethical commercial dealings categorized mainly as non-supply/ partial supply of goods after confirmation of order; supplying goods other than the ones as agreed upon; non-payment; non-adherence to delivery schedules, etc.

### Obligation on the part of importer/ exporter

- (a) Rule 11 of the Foreign Trade (Regulation) Rules, 1993, requires that on the importation into, or exportation out of, any customs ports of any goods, whether liable to duty or not, the owner of such goods shall in the Bill of Entry or the Shipping Bill or any other documents prescribed under the Customs Act, 1962 (52 of 1962), state the value, quality and description of such goods to the best of his knowledge and belief and in case of exportation of goods, certify that the quality and specification of the goods as stated in those documents, are in accordance with the terms of the export contract entered into with the buyer or consignee in pursuance of which the goods are being exported and shall subscribe a declaration of the truth of such statement at the foot of such Bill of Entry or Shipping Bill or any other documents. Violation of this provision renders the exporter liable for penal action.
- (b) Certain export commodities have been notified for Compulsory Quality Control & Pre-shipment Inspection prior to their export. Penal action can be taken under the Export (Quality Control & Inspection) Act, 1963 as amended in 1984, against exporters who do not conform to these standards and/ or provisions of the Act as laid down for such products.

## Provisions in FT (D&R) Act & FT (Regulation) Rules for necessary action against erring exporters / importers

Action against erring exporters can be taken under the Foreign Trade (Development and Regulation) Act, 1992, as amended and under Foreign Trade (Regulation) Rules, 1993, as follows:-

- (a) Section 8 of the Act empowers the Director General of Foreign Trade or any other person authorized by him to suspend or cancel the Importer Exporter Code Number for the reasons as given therein.
- (b) Section 9 (2) of the Act empowers the Director General of Foreign Trade or an officer authorised by him to refuse to grant or renew a license, certificate, scrip or any other instrument bestowing financial or fiscal benefit granted under the Act.
- (c) Section 9(4) empowers the Director General of Foreign Trade or the officer authorized by him to suspend or cancel any License, certificate, scrip or any instrument bestowing financial or fiscal benefit granted under the Act.
- (d) Section 11(2) of the Act provides for imposition of fiscal penalty in cases where a person makes or abets or attempts to make any import or export in contravention of any provision of the Act, any Rules or Orders made there under or the Foreign Trade Policy.

## Mechanism for handling of Complaints/ Disputes

### (a) Committee on Quality complaints and Trade Disputes (CQCTD)

To deal effectively with the increasing number of complaints and disputes, a 'Committee on Quality Complaints and Trade Disputes' (CQCTD) will be constituted in the 22 offices of the Regional Authority(RA's) of DGFT.

### (b) Composition of the CQCTD

The CQCTD would be constituted under the Chairpersonship of the Head of Office. The CQCTD may comprise of the following members:

- (1) Additional DGFT/Joint DGFT/ (H.O.O): Chairperson
- (2) Representative of Bureau of India Standard (BIS): Member
- (3) Representative of Agricultural and Processed Food Products Export Development Authority: Member
- (4) Representative of the Branch Manager of the concerned Bank: Member
- (5) Representative of Federation of Indian Exporter Organisation/and OR Export Promotion Council: Member
- (6) Representative of Export Inspection Agency: Member
- (7) Nominee of Director of Industries of State Government: Member
- (8) Nominee of Development Commissioner of MSME: Member
- (9) Officer as nominated by Chairperson: Member Secretary
- (10) Any other agency, as co-opted by Chairperson: Member.

### (c) Functions of CQCTD

The Committee (CQCTD) will be responsible for enquiring and investigating into all Quality related complaints and other trade related complaints falling under the jurisdiction of the respective RAs. It will take prompt and effective steps to redress and resolve the grievances of the importers, exporters and overseas buyers, preferably within three months of receipt of the complaint. Wherever required, the Committee (CQCTD) may take the assistance of the Export Promotion Councils/FIEO/Commodity Boards or any other agency as considered appropriate for settlement of these disputes.

## Proceedings under CQCTD

CQCTD proceedings are only reconciliatory in nature and the aggrieved party, whether the foreign buyer or the Indian importer, is free to pursue any legal recourse against the other erring party.

## Procedures to deal with complaints and trade disputes

The procedure for making an application for such complaints or trade disputes and the procedure to deal with such quality complaints and disputes is given in the Handbook of Procedures.

## Corrective Measures

The Committee at RA level can authorize the Export Inspection Agency or any technical authority to assess whether there has been any technical failure or not meeting the standards, manufacturing/ design defects, etc. for which complaints have been received.

## Nodal Officer

Director General of Foreign Trade would appoint an officer, not below the rank of Joint Director General, in the Headquarters, to function as the 'Nodal Officer' for coordinating with various Regional Authorities of DGFT.

### LESSON ROUND-UP

- India's Foreign Trade Policy (FTP) has, conventionally, been formulated for five years at a time and reviewed annually. The focus of the FTP has been to provide a framework of rules and procedures for exports and imports and a set of incentives for promoting exports.
- The Foreign Trade Policy is primarily focused on accelerating exports. This is sought to be implemented through various schemes intended to exempt and remit indirect taxes on inputs physically incorporated in the export product, import capital goods at concessional duty, stimulate services exports and focus on specific markets and products.
- The Foreign Trade Policy, 2015-20, is notified by Central Government, in exercise of powers conferred under Section 5 of the Foreign Trade (Development & Regulation) Act, 1992 (No. 22 of 1992) [FT (D&R) Act], as amended. The Foreign Trade Policy, 2015-20 came into force with effect from 01.04.2015.
- Capital Goods means any plant, machinery, equipment or accessories required for manufacture or production, either directly or indirectly, of goods or for rendering services, including those required for replacement, modernisation, technological up-gradation or expansion. It includes packaging machinery and equipment, refrigeration equipment, power generating sets, machine tools, equipment and instruments for testing, research and development, quality and pollution control.
- An Importer-Exporter Code (IEC) Number is a 10-digit number allotted to a person that is mandatory for undertaking any export/import activities. Now the facility for IEC in electronic form or e-IEC has also been operationalised.
- The objective of the Export from India Schemes is to provide rewards to exporters to offset infrastructural inefficiencies and associated costs involved and to provide exporters a level playing field.
- Status Holders are business leaders who have excelled in international trade and have successfully contributed to country's foreign trade. Status Holders are expected to not only contribute towards India's exports but also provide guidance and handholding to new entrepreneurs.
- The objective of the Export Promotion Capital Goods (EPCG) Scheme is to facilitate import of capital goods for producing quality goods and services to enhance India's export competitiveness.

- Units undertaking to export their entire production of goods and services (except permissible sales in DTA), may be set up under the Export Oriented Unit (EOU) Scheme, Electronics Hardware Technology Park (EHTP) Scheme, Software Technology Park (STP) Scheme or Bio-Technology Park (BTP) Scheme for manufacture of goods, including repair, re-making, reconditioning, re-engineering, rendering of services, development of software, agriculture including agro-processing, aquaculture, animal husbandry, biotechnology, floriculture, horticulture, pisciculture, viticulture, poultry and sericulture. Trading units are not covered under these schemes.

### TEST YOURSELF

1. What are the objectives of foreign trade policy?
2. Discuss briefly the Export Oriented Unit (EOU) Scheme under FTP 2015-20.
3. What do you mean by IEC Number/e-IEC?
4. Distinguish between Merchandise Exports from India Scheme (MEIS) and Service Exports from India Scheme (SEIS).
5. Write short notes on:
  - Status Holder
  - Quality Complaints and Trade Disputes



## Lesson 10

# Non-Banking Financial Companies (NBFCs)

### ***Key Concepts One Should Know***

- Non-Banking Financial Company
- Systemically Important Non-Deposit taking Non-Banking Financial Company
- Infrastructure Finance Company
- Investment and Credit Company
- Core Investment

### ***Learning Objectives***

#### **To understand:**

- Types of NBFC
- Activities of NBFCs
- Compliances by the NBFCs
- Deposit Accepting and Non-deposit Accepting NBFCs
- Core Investment Company
- Systemically Important Core Investment Companies
- Peer to Peer Lending.

### ***Regulatory Framework***

- Reserve Bank of India Act, 1934
- RBI Directions for NBFCs

### ***Lesson Outline***

- Introduction
- Non-Banking Financial Companies
- Registration and Net Owned Fund
- Cancelation of a Certificate of Registration
- Supersession of Board of Directors of NBFCs
- Resolution of Non-Banking Financial Company
- Directions issued by Reserve Bank of India
- Systemically Important Non-Deposit taking NBFCs
- Infrastructure Finance Company
- Investment and Credit Company
- Core Investment Company
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

Non-banking financial institutions (NBFIs) comprise a heterogeneous group of financial intermediaries. Those under the regulatory purview of the Reserve Bank consist of all-India financial institutions (AIFIs), nonbanking financial companies (NBFCs) and primary dealers (PDs). AIFIs are apex institutions established during the development planning era to provide long-term financing/refinancing to specific sectors such as (i) agriculture and rural development; (ii) trade; (iii) small industries; and (iv) housing. NBFCs are dominated by joint stock companies, catering to niche areas ranging from personal loans to infrastructure financing. PDs play an important role as market makers for government securities.

Although housing finance companies, merchant banking companies, stock exchanges, companies engaged in the business of stockbroking/sub-broking, venture capital fund companies, Nidhi companies, insurance companies and chit fund companies are also NBFCs, they have been exempted from the requirement of registration with the Reserve Bank under Section 45-IA of the RBI Act, 1934.

Non-Banking Finance Companies (NBFCs) have played an important role in the Indian financial system by complementing and competing with banks, and by bringing in efficiency and diversity into financial intermediation. NBFCs have evolved considerably in terms of operations, heterogeneity, asset quality and profitability, and regulatory architecture. Going forward, the growing systemic importance and interconnectedness of this sector calls for regulatory vigil.

The world over, non-banking financial entities complement the mainstream banking system in the process of financial intermediation. In emerging economies, they often play an important role because of their ability to reach out to inaccessible areas; and (b) act as not just complements but also substitutes to banks when the banks are confronted with stricter regulatory constraints. Customers tend to find the non-banking entities convenient due to their quicker decision-making ability, prompt provision of services and expertise in niche segments. Apart from widening the ambit of and access to financial services, they also enhance the resilience of the financial system by acting as backup institutions when banks come under stress.

## REGULATORY ENVIRONMENT FOR NBFCs

NBFCs were brought under the regulation of the Reserve Bank in 1964 by inserting Chapter III B in the Reserve Bank of India Act, 1934. In more recent years, regulatory measures have been motivated by the objectives of financial stability, financial inclusion and harnessing of specialised domain expertise. NBFCs suggests that they are emerging as an important source of credit to micro and small enterprises and infrastructure.

*Chapter III B of Reserve Bank of India Act, 1934 (Section 45-I TO 45QB) deals with provisions relating to non-banking institutions receiving deposits and financial institutions.*

### Definition of NBFC under RBI Act

According to Section 45-I(f) of the Reserve Bank of India Act, 1934, “**Non-Banking Financial Company**” means—

- (i) a financial institution which is a company;
- (ii) a non-banking institution which is a company and which has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner, or lending in any manner;
- (iii) such other non-banking institution or class of such institutions, as the Reserve Bank of India may, with the previous approval of the Central Government and by notification in the Official Gazette, specify.

It may be noted that as per Section 45-I (c) of the Reserve Bank of India Act, 1934, “**Financial Institution**” means any non-banking institution which carries on as its business or part of its business any of the following activities, namely:—

- (i) the financing, whether by way of making loans or advances or otherwise, of any activity other than its own;
- (ii) the acquisition of shares, stock, bonds, debentures or securities issued by a Government or local authority or other marketable securities of a like nature;
- (iii) letting or delivering of any goods to a hirer under a hire-purchase agreement as defined in clause (c) of section 2 of the Hire-Purchase Act, 1972;
- (iv) the carrying on of any class of insurance business;
- (v) managing, conducting or supervising, as foreman, agent or in any other capacity, of chits or kuries as defined in any law which is for the time being in force in any State, or any business, which is similar thereto;
- (vi) collecting, for any purpose or under any scheme or arrangement by whatever name called, monies in lump sum or otherwise, by way of subscriptions or by sale of units, or other instruments or in any other manner and awarding prizes or gifts, whether in cash or kind, or disbursing monies in any other way, to persons from whom monies are collected or to any other person,

but does not include any institution, which carries on as its principal business,—

- (a) agricultural operations; or
- (aa) industrial activity; or
- (b) the purchase, or sale of any goods (other than securities) or the providing of any services; or
- (c) the purchase, construction or sale of immovable property, so, however, that no portion of the income of the institution is derived from the financing of purchases, constructions or sales of immovable property by other persons;

According to Section 45-I (e) of the Reserve Bank of India Act, 1934, "**Non-banking institution**" means a company, corporation or co-operative society;

Further as per Section 45-I (bb) of the Reserve Bank of India Act, 1934, "**Deposit**" includes and shall be deemed always to have include any receipt of money by way of deposit or loan or in any other form, *but does not include*,—

- (i) amounts raised by way of share capital;
- (ii) amounts contributed as capital by partners of a firm;
- (iii) amounts received from a scheduled bank or a co-operative bank or any other banking company as defined in clause (c) of section 5 of a Banking Regulation Act, 1949;
- (iv) any amount received from,—
  - (b) a State Financial Corporation,
  - (c) any financial institution specified in or under section 6A of the Industrial Development Bank of India Act, 1964, or
  - (d) any other institution that may be specified by the Bank in this behalf;
- (v) amounts received in the ordinary course of business, by way of—
  - (a) security deposit,
  - (b) dealership deposit,
  - (c) earnest money, or
  - (d) advance against orders for goods, properties or services;
- (vi) any amount received from an individual or a firm or an association of individuals not being a body corporate, registered under any enactment relating to money lending which is for the time being in force in any State; and
- (vii) any amount received by way of subscriptions in respect of a chit.

Explanation I.—"Chit" has the meaning assigned to it in clause (b) of section 2 of the Chit Funds Act, 1982.

Explanation II.—Any credit given by a seller to a buyer on the sale of any property (whether movable or immovable) shall not be deemed to be deposit for the purposes of this clause.

## Registration and Net Owned Fund

Section 45-IA of the Reserve Bank of India Act, 1934 deals with requirement of registration and net owned Fund. Section 45-IA provides that notwithstanding anything contained in Chapter IIIB of the RBI Act or in any other law for the time being in force, no non-banking financial company shall commence or carry on the business of a non-banking financial institution without—

- (a) obtaining a certificate of registration issued under Chapter IIIB; and
- (b) having the net owned fund of twenty-five lakh rupees or such other amount, not exceeding hundred crore rupees, as the Bank may, by notification in the Official Gazette, specify:

Provided that the Reserve Bank of India may notify different amounts of net owned fund for different categories of non-banking financial companies.

Every non-banking financial company shall make an application for registration to the Bank in such form as the Reserve Bank of India may specify.

***The Reserve Bank of India, for the purpose of considering the application for registration, may require to be satisfied by an inspection of the books of the non-banking financial company or otherwise that the following conditions are fulfilled:—***

- (a) that the non-banking financial company is or shall be in a position to pay its present or future depositors in full as and when their claims accrue;
- (b) that the affairs of the non-banking financial company are not being or are not likely to be conducted in a manner detrimental to the interest of its present or future depositors;
- (c) that the general character of the management or the proposed management of the non-banking financial company shall not be prejudicial to the public interest or the interests of its depositors;
- (d) that the non-banking financial company has adequate capital structure and earning prospects;
- (e) that the public interest shall be served by the grant of certificate of registration to the non-banking financial company to commence or to carry on the business of India;
- (f) that the grant of certificate of registration shall not be prejudicial to the operation and consolidation of the financial sector consistent with monetary stability, and economic growth considering such other relevant factors which the Reserve Bank of India may, by notification in the Official Gazette, specify; and
- (g) any other condition, fulfilment of which in the opinion of the Reserve Bank of India, shall be necessary to ensure that the commencement of or carrying on of the business in India by a non-banking financial company shall not be prejudicial to the public interest or in the interests of the depositors.

The Reserve Bank of India may, after being satisfied that the specified conditions are fulfilled, grant a certificate of registration subject to such conditions which it may consider fit to impose.

## Cancelation of a Certificate of Registration

The Reserve Bank of India may cancel a certificate of registration granted to a non-banking financial company under Section 45-IA of the Reserve Bank of India Act, 1934, if such company—

- (i) ceases to carry on the business of a non-banking financial institution in India; or
- (ii) has failed to comply with any condition subject to which the certificate of registration had been issued to it; or
- (iii) at any time fails to fulfil any of the conditions such as adequate capital structure and earning prospects; public interest, monetary stability, and economic growth etc. or
- (iv) fails to comply with any direction issued by the Reserve Bank of India under the provisions of Chapter III B of RBI Act ; or fails to maintain accounts in accordance with the requirements of any law or any direction or order issued by the Reserve Bank of India under the provisions of Chapter III B of RBI Act ; or fails to submit

or offer for inspection its books of account and other relevant documents when so demanded by an inspecting authority of the Reserve Bank of India ; or has been prohibited from accepting deposit by an order made by the Reserve Bank of India under the provisions of Chapter III B of RBI Act and such order has been in force for a period of not less than three months.

A company aggrieved by the order of rejection of application for registration or cancellation of certificate of registration may prefer an Appeal, within a period of thirty days from the date on which such order of rejection or cancellation is communicated to it, to the Central Government and the decision of the Central Government where an appeal has been preferred to it, or of the Bank where no appeal has been preferred, shall be final.

### Maintenance of Percentage of Assets

According to Section 45-IB of the Reserve Bank of India Act, 1934, every non-banking financial company shall invest and continue to invest in India in unencumbered approved securities, valued at a price not exceeding the current market price of such securities, an amount which, at the close of business on any day, shall not be less than five per cent. or such higher percentage not exceeding twenty-five per cent. as the Reserve Bank of India may, from time to time and by notification in the Official Gazette, specify, of the deposits outstanding at the close of business on the last working day of the second preceding quarter.

It may be noted that:

- (i) "approved securities" means securities of any State Government or of the Central Government and such bonds, both the principal whereof and the interest whereon shall have been fully and unconditionally guaranteed by any such Government;
- (ii) "unencumbered approved securities" includes the approved securities lodged by the nonbanking financial company with another institution for an advance or any other arrangement to the extent to which such securities have not been drawn against or availed of or encumbered in any manner;

Further, the Reserve Bank of India may specify different percentages of investment in respect of different classes of non-banking financial companies.

For the purpose of ensuring compliance, the Reserve Bank of India may require every non-banking financial company to furnish a return to it in such form, in such manner and for such period as may be specified by the Reserve Bank of India.

If the amount invested by a non-banking financial company at the close of business on any day falls below the specified rate , such company shall be liable to pay to the Reserve Bank of India , in respect of such shortfall, a penal interest at a rate of three per cent. per annum above the bank rate on such amount by which the amount actually invested falls short of the specified percentage, and where the shortfall continues in the subsequent quarters, the rate of penal interest shall be five per cent. per annum above the bank rate on such shortfall for each subsequent quarter.

The penal interest payable by a non-banking financial company shall be payable within a period of fourteen days from the date on which a notice issued by the Reserve Bank of India demanding payment of the same is served on the non-banking financial company and, in the event of a failure of the non-banking financial company to pay the same within such period, penalty may be levied by a direction of the principal civil court having jurisdiction in the area where an office of the defaulting non-banking financial company is situated and such direction shall be made only upon an application made in this behalf to the court by the a non-banking financial company ; and When the court makes a direction , it shall issue a certificate specifying the sum payable by the non-banking financial company and every such certificate shall be enforceable in the same manner as if it were a decree made by the court in a suit.

### Reserve Fund

Section 45-IC of the Reserve Bank of India Act, 1934 provides that every non-banking financial company shall create a reserve fund the transfer therein a sum not less than twenty per cent. of its net profit every year as disclosed in the profit and loss account and before any dividend is declared.

Appropriation of any sum from the reserve fund shall not be made by the non-banking financial company except for the purpose as may be specified by the Reserve Bank of India from time to time and every such appropriation shall be reported to the Reserve Bank of India within twenty-one days from the date of such withdrawal:

It may be noted that the Reserve Bank of India may, in any particular case and for sufficient cause being shown, extend the period of twenty-one days by such further period as it thinks fit or condone any delay in making such report.

The Central Government may, on the recommendation of the Reserve Bank of India and having regard to the adequacy of the paid-up capital and reserves of a non-banking financial company in relation to its deposit liabilities, declare by order in writing that the provisions of reserve fund shall not be applicable to the non-banking financial company for such period as may be specified in the order:

### Power of Reserve Bank of India to Remove Directors from Office

As per Section 45-ID of the Reserve Bank of India Act, 1934, where the Reserve Bank is satisfied that in the public interest or to prevent the affairs of a non-banking financial company being conducted in a manner detrimental to the interest of the depositors or creditors, or financial stability or for securing the proper management of such company, it is necessary so to do, the Reserve Bank may, by order and for reasons to be recorded in writing, remove from office, a director (by whatever name called) of such company, other than Government owned non-banking financial company with effect from such date as may be specified in the said order.

No order removal shall be made unless the director concerned has been given a reasonable opportunity of making a representation to the Bank against the proposed order.

It may be noted that if, in the opinion of the Reserve Bank, any delay will be detrimental to the interest of the said company or its depositors, the Reserve Bank may, at the time of giving the aforesaid opportunity or at any time thereafter, by order direct that, pending the consideration of the representation, if any, the director, shall not, with effect from the date of such order

- (a) act as such director of that company;
- (b) in any way, whether directly or indirectly, be concerned with or take part in the management of that company.

Where any order of removal is made in respect of a director of a company, he shall cease to be a director of that non-banking financial company and shall not, in any way, whether directly or indirectly, be concerned with, or take part in the management of any non-banking financial company for such period not exceeding five years at a time as may be specified in the order.

Where an order of removal has been made, the Reserve Bank may, by order in writing, appoint a suitable person in place of the director, who has been so removed from his office, with effect from such date as may be specified in such order.

Any person appointed Reserve Bank shall,—

- (a) hold office during the pleasure of the Reserve Bank and subject thereto for a period not exceeding three years or such further periods not exceeding three years at a time;
- (b) not incur any obligation or liability by reason only of his being a director for anything done or omitted to be done in good faith in the execution of the duties of his office or in relation thereto.

Notwithstanding anything contained in any other law for the time being in force or in any contract, memorandum or articles of association, on the removal of a director from office under section 45-ID, such director shall not be entitled to claim any compensation for the loss or termination from office.

## Supersession of Board of Directors of Non-Banking Financial Company

Section 45-IE of the Reserve Bank of India Act, 1934 provides that where the Reserve Bank is satisfied that in the public interest or to prevent the affairs of a non-banking financial company being conducted in a manner detrimental to the interest of the depositors or creditors, or of the non-banking financial company (other than Government Company), or for securing the proper management of such company or for financial stability, it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, supersede the Board of Directors of such company for a period not exceeding five years as may be specified in the order, which may be extended from time to time, so, however, that the total period shall not exceed five years.

The Reserve Bank may, on supersession of the Board of Directors of the non-banking financial company, appoint a suitable person as the Administrator for such period as it may determine.

The Reserve Bank may issue such directions to the Administrator as it may deem appropriate and the Administrator shall be bound to follow such directions.

Upon making the order of supersession of the Board of Directors of a non-banking financial company,—

- (a) the chairman, managing director and other directors shall from the date of super session of the Board of Directors vacate their offices;
- (b) all the powers, functions and duties, which may, by or under the provisions of RBI Act or any other law for the time being in force, be exercised and discharged by or on behalf of the Board of Directors of such non-banking financial company or by a resolution passed in general meeting of such non-banking financial company, shall, until the Board of Directors of such company is reconstituted, be exercised and discharged by the Administrator.

## Reserve Bank to Regulate or Prohibit Issue of Prospectus or Advertisement Soliciting Deposits of Money

Section 45J of the Reserve Bank of India Act, 1934 empowers the Reserve Bank, if it consider necessary in the public interest so to do, by general or special order,—

- (a) regulate or prohibit the issue by any non-banking institution of any prospectus or advertisement soliciting deposits of money from the public, and
- (b) specify the conditions subject to which any such prospectus or advertisement, if not prohibited, may be issued.

## Power of Bank to Determine Policy and Issue Directions

According to Section 45JA of the Reserve Bank of India Act, 1934, If the Bank is satisfied that, in the public interest or to regulate the financial system of the country to its advantage or to prevent the affairs of any non-banking financial company being conducted in manner detrimental to the interest of the depositors or in a manner prejudicial to the interest of the non-banking financial company, it is necessary or expedient so to do, it may determine the policy and give directions to all or any of the non-banking financial companies relating to income recognition, accounting standards, making of proper provision for bad and doubtful debts, capital adequacy based on risk weights for assets and credit conversion factors for off balance-sheet items and also relating to deployment of funds by a non-banking financial company or a class of non-banking financial companies or non-banking financial companies generally, as the case may be, and such non-banking financial companies shall be bound to follow the policy so determined and the direction so issued.

Reserve Bank of India may give directions to non-banking financial companies generally or to a class of non-banking financial companies or to any non-banking financial company in particular as to—

- (a) the purpose for which advances or other fund based or non-fund based accommodation may not be made; and
- (b) the maximum amount of advances of other financial accommodation or investment in shares and other securities which, having regard to the paid-up capital, reserves and deposits of the non-banking financial company and other relevant considerations, may be made by that non-banking financial company to any person or a company or to a group of companies.

## Power of Bank to Collect Information from Non-Banking Institutions as to Deposits and to Give Directions

Section 45K of the Reserve Bank of India Act, 1934 provides that the Reserve Bank may at any time direct that every non-banking institution shall furnish to the Reserve Bank, in such form, at such intervals and within such time, such statements information or particulars relating to or connected with deposits received by the non-banking institution, as may be specified by the Reserve Bank by general or special order.

The statements, information or particulars to be furnished to the Reserve Bank may relate to all or any of the matters, namely, the amount of the deposits, the purposes and periods for which, and the rates of interest and other terms and conditions on which, they are received.

The Reserve Bank may, if it considers necessary in the public interest so to do, give directions to nonbanking institutions either generally or to any non-banking institution or group of non-banking institutions in particular, in respect of any matters relating to or connected with the receipt of deposits, including the rates of interest payable on such deposits, and the periods for which deposits may be received.

If any non-banking institution fails to comply with any direction given by the Reserve Bank, the Reserve Bank may prohibit the acceptance of deposits by that non-banking institution.

Every non-banking institution receiving deposits shall, if so required by the Reserve Bank and within such time as the Reserve Bank may specify, cause to be sent at the cost of the non-banking institution a copy of its annual balance-sheet and profit and loss account or other annual accounts to every person from whom the non-banking institution holds, as on the last day of the year to which the accounts relate, deposits higher than such sum as may be specified by the Reserve Bank.

## Power of Bank to Call for Information from Financial Institutions and to Give Directions

Section 45L of the Reserve Bank of India Act, 1934 states that if the Reserve Bank is satisfied for the purpose of enabling it to regulate the credit system of the country to its advantage it is necessary so to do, it may—

- (a) require financial institutions either generally or any group of financial institutions or financial institution in particular, to furnish to the Reserve Bank in such form, at such intervals and within such time, such statements, information or particulars relating to the business of such financial institutions or institution, as may be specified by the Reserve Bank by general or special order;
- (b) give to such institutions either generally or to any such institution in particular, directions relating to the conduct of business by them or by it as financial institutions or institution.

The statements, information or particulars to be furnished by a financial institution to the Reserve Bank may relate to all or any of the following matters, namely, the paid-up capital, reserves or other liabilities, the investments whether in Government securities or otherwise, the persons to whom, and the purposes and periods for which, finance is provided and the terms and conditions, including the rates of interest, on which it is provided.

In issuing directions to any financial institution the Reserve Bank shall have due regard to the conditions in which, and the objects for which, the institution has been established, its statutory responsibilities, if any, and the effect the business of such financial institution is likely to have on trends in the money and capital markets.

## Duty of Non-Banking Institutions to Furnish Statements Required By Reserve Bank

Section 45M of the Reserve Bank of India Act, 1934 provides that it shall be the duty of every non-banking institution to furnish the statements, information or particulars called for, and to comply with any direction given to it, under the provisions of this Chapter.

## Powers and Duties of Auditors

Section 45MA(1) of the Reserve Bank of India Act, 1934 provides that it shall be the duty of an auditor of a non-banking institution to inquire whether or not the non-banking institution has furnished to the Bank such statements, information or particulars relating to or connected with deposits received by it, as are required to be furnished

under this Chapter, and the auditor shall, except where he is satisfied on such inquiry that the non-banking institution has furnished such statements, information or particulars, make a report to the Bank giving the aggregate amount of such deposits held by the non-banking institution.

The Reserve Bank may, on being satisfied that it is necessary so to do, in the public interest or in the interest of the depositors or for the purpose of proper assessment of the books of accounts, issue directions to any non-banking financial company or any class of non-banking financial companies or non-banking financial companies generally or to the auditors of such non-banking financial company or companies relating to balance-sheet, profit and loss account, disclosure of liabilities in the books of accounts or any matter relating thereto.

Where, in the case of a non-banking financial company, the auditor has made, or intends to make, a report to the Reserve Bank under Section 45MA(1) above, he shall include in his report under the Companies Act, the contents of the report which he has made or intends to make, to the Reserve Bank.

Where the Reserve Bank is of the opinion that it is necessary so to do in the public interest or in the interest of the non-banking financial company or in the interest of depositors of such company it may at any time by order direct that a special audit of the accounts of the non-banking financial company in relation to any such transaction or class of transactions or for such period or periods, as may be specified in the order, shall be conducted and the Reserve Bank may appoint an auditor or auditors to conduct such special audit and direct the auditor or the auditors to submit the report to it.

The remuneration of the auditors as may be fixed by the Reserve Bank, having regard to the nature and volume of work involved in the audit and the expenses of or incidental to the audit, shall be borne by the non-banking financial company so audited.

### **Power to Take Action against Auditors**

According to Section 45MAA of the Reserve Bank of India Act, 1934, where any auditor fails to comply with any direction given or order made by the Reserve Bank under section 45MA, the Reserve Bank, may, if satisfied, remove or debar the auditor from exercising the duties as auditor of any of the Reserve Bank regulated entities for a maximum period of three years, at a time.

### **Power of Bank to Prohibit Acceptance of Deposit and Alienation of Assets**

Section 45MAB of the Reserve Bank of India Act, 1934 provides that if any non-banking financial company violates the provisions of any section or fails to comply with any direction or order given by the Bank under any of the provisions of this Chapter IIIB, the Reserve Bank may prohibit the non-banking financial company from accepting any deposit.

Notwithstanding anything to the contrary contained in any agreement or instruments or any law for the time being in force, the Reserve Bank, on being satisfied that it is necessary so to do in the public interest or in the interest of the depositors, may direct, the non-banking financial company against which an order prohibiting from accepting deposit has been issued, not to sell, transfer, create charge or mortgage or deal in any manner with its property and assets without prior written permission of the Reserve Bank for such period not exceeding six months from the date of the order.

### **Resolution of Non-Banking Financial Company**

Section 45MABA(1) of the Reserve Bank of India Act, 1934 provides that without prejudice to any other provision of the RBI Act or any other law for the time being in force, the Reserve Bank may, if it is satisfied, upon an inspection of the Books of a non-banking financial company that it is in the public interest or in the interest of financial stability so to do for enabling the continuance of the activities critical to the functioning of the financial system, frame schemes which may provide for any one or more of the following, namely:—

- (a) amalgamation with any other non-banking institution;
- (b) reconstruction of the non-banking financial company;

- (c) splitting the non-banking financial company into different units or institutions and vesting viable and non-viable businesses in separate units or institutions to preserve the continuity of the activities of that non-banking financial company that are critical to the functioning of the financial system and for such purpose establish institutions called "Bridge Institutions".

**Explanation.**—For the purposes of this sub-section, "Bridge Institutions" mean temporary institutional arrangement made under the scheme referred to in this sub-section, to preserve the continuity of the activities of a non-banking financial company that are critical to the functioning of the financial system.

Section 45MABA(2) of the Reserve Bank of India Act, 1934 states that without prejudice to the generality of the foregoing provisions, the scheme referred to in Section 45MABA (1) may provide for—

- (a) reduction of the pay and allowances of the chief executive officer, managing director, chairman or any officer in the senior management of the non-banking financial company;
- (b) cancellation of all or some of the shares of the non-banking financial company held by the chief executive officer, managing director, chairman or any officer in the senior management of the non-banking financial company or their relatives;
- (c) sale of any of the assets of the non-banking financial company.

### **Power of Reserve Bank to File Winding Up Petition**

According to Section 45MC of the Reserve Bank of India Act, 1934, the Reserve Bank, on being satisfied that a non-banking financial company—

- (a) is unable to pay its debt; or
- (b) has by virtue of the provisions of section 45-IA become disqualified to carry on the business of a non-banking financial institution; or
- (c) has been prohibited by the Reserve Bank from receiving deposit by an order and such order has been in force for a period of not less than three months; or
- (d) the continuance of the non-banking financial company is detrimental to the public interest or to the interest of depositors of the company,

may file an application for winding up of such non-banking financial company under the Companies Act.

A non-banking financial company shall be deemed to be unable to pay its debt if it has refused or has failed to meet within five working days any lawful demand made at any to its offices or branches and the Bank certifies in writing that such company is unable to pay its debt.

A copy of every application made by the Reserve Bank shall be sent to the Registrar of Companies. All the provisions of the Companies Act, relating to winding up of a company shall apply to a winding up proceeding initiated on the application made by the Bank under this provision.

### **Power in Respect of Group Companies**

Section 45NAA of the Reserve Bank of India Act, 1934, provides that the Reserve Bank may, at any time, direct a non-banking financial company to annex to its financial statements or furnish separately, within such time and at such intervals as may be specified by the Bank, such statements and information relating to the business or affairs of any group company of the non-banking financial company as the Bank may consider necessary or expedient to obtain for the purposes of RBI Act.

Notwithstanding anything to the contrary contained in the Companies Act, 2013, the Reserve Bank may, at any time, cause an inspection or audit to be made of any group company of a non-banking financial company and its books of account.

## Disclosure of Information

According to Section 45NB (1) of the Reserve Bank of India Act, 1934, any information relating to a non-banking financial company,—

- (i) Contained in any statement or return submitted by such company under the provisions of Chapter IIIB; or
- (ii) Obtained through audit or inspection or otherwise by the Bank, shall be treated as confidential and shall not, except otherwise provided in Section 45NB, be disclosed.

Section 45NB (2) provides that nothing in section 45NB shall apply to—

- (a) the disclosure by any non-banking financial company, with the previous permission of the Reserve Bank, of any information furnished to the Reserve Bank under sub-section (1);
- (b) the publication by the Reserve Bank, if it considers necessary in the public interest so to do, of any information collected by it under sub-section (1) in such consolidated form as it may think fit without disclosing the name of any non-banking financial company or its borrowers;
- (c) the disclosure or publication by the non-banking financial company or by the Reserve Bank of any such information to any other non-banking financial company or in accordance with the practice and usage customary amongst such companies or as permitted or required under any other law:

Provided that any such information received by a non-banking financial company under this clause shall not be published except in accordance with the practice and usage customary amongst companies or as permitted or required under any other law.

Notwithstanding anything contained in RBI Act or in any other law for the time being in force, the Reserve Bank, if it is satisfied that, in the public interest or in the interest of the depositors or the non-banking financial company or to prevent the affairs of any non-banking financial company being conducted in a manner detrimental to the interest of the depositors, it is expedient so to do, may, either on its own motion or on being requested, furnish or communicate any information relating to the conduct of business by any non-banking financial company to any authority constituted under any law.

Notwithstanding anything contained in any law for the time being in force, no court or tribunal or other authority shall compel the Reserve Bank to produce or to give inspection of any statement or other material obtained by the Reserve Bank under any provisions of Chapter IIIB.

## Power of Reserve Bank to Exempt

Section 45NC of the Reserve Bank of India Act, 1934 states that the Reserve Bank, on being satisfied that it is necessary so to do, may declare by notification in the Official Gazette that any or all of the provisions of Chapter IIIB of the RBI Act shall not apply to a non-banking institution or a class of non-banking institutions or a non-banking financial company or to any class or non-banking financial companies either generally or for such period as may be specified, subject to such conditions, limitations or restrictions as it may think fit to impose.

## Chapter IIIB OF RBI Act to Override Other Laws

According to Section 45Q of the Reserve Bank of India Act, 1934, the provisions of this Chapter IIIB of RBI Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or any instrument having effect by virtue of any such law.

## DIRECTIONS PERTAINING TO NBFCs ISSUED BY RESERVE BANK OF INDIA

The Reserve Bank of India in the public interest and to regulate the financial system to the advantage of the country and to prevent the affairs of any Non-Banking Financial Companies (NBFCs) from being conducted in a manner detrimental to the interest of investors or in any manner prejudicial to the interest of such NBFCs issues Directions from time to time.

Following are the major Directions issued by Reserve Bank of India are as under:

- Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016
- Non-Banking Financial Company -Non-Systemically Important Non-Deposit taking (Reserve Bank) Directions, 2016
- Core Investment Companies (Reserve Bank) Directions, 2016
- Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016
- Non-Banking Financial Company Returns (Reserve Bank) Directions, 2016
- Non-Banking Financial Companies Auditor's Report (Reserve Bank) Directions, 2016
- Monitoring of Frauds in NBFCs (Reserve Bank) Directions, 2016
- Non-Banking Financial Company - Account Aggregator (Reserve Bank) Directions, 2016
- Miscellaneous Non-Banking Companies (Reserve Bank) Directions, 2016
- Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017

### CLASSIFICATION OF NBFCs BY ACTIVITY

NBFCs are classified on the basis of: (a) their liability structures; (b) the type of activities they undertake; and (c) their systemic importance. In the first category, NBFCs are further subdivided into NBFCs-D-which are authorized to accept and hold public deposits-and non-deposit taking NBFCs (NBFCs-ND)- which do not accept public deposits but raise debt from market and banks. NBFCs can also be categorised on the basis of activities undertaken as they typically focus on niche segments and fulfil sector-specific requirements.

| TYPE OF NBFC  | ACTIVITY   |
|---|--|
| Asset Finance Company (AFC)<br>(NBFC-Investment and Credit Companies) | Financing of physical assets including automobiles, tractors and generators.   |
| Loan Company<br>(NBFC-Investment and Credit Companies)                | Provision of loan finance  |
| Investment Company<br>(NBFC-Investment and Credit Companies)          | Acquisition of securities for purpose of selling   |
| NBFC-Infrastructure Finance Company (NBFC-IFC)                        | Provision of infrastructure loans  |
| NBFC-Systemically Important Core Investment Company (CIC-ND-SI)       | Makes investments and loans to group companies   |
| Infrastructure Debt Fund-NBFC (IDF-NBFC)                              | Facilitation of flow of long-term debt into infrastructure projects  |
| NBFC-Micro Finance Institution (NBFC-MFI)                             | Credit to economically dis-advantaged groups   |
| NBFC-Factor   | Acquisition of receivables of an assignor or extending loans against the security interest of thereceivables at a discount |
| NBFC-Non-Operative Financial Holding Company (NOFHC)                  | Facilitation of promoters/ promoter groups in setting up new banks   |
| Mortgage Guarantee Company (MGC)                                      | Undertaking of mortgage guarantee business   |

|   |  |
|---|--|
| NBFC-Account Aggregator (NBFC-AA)             | Collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer. |
| NBFC-Peer to Peer Lending Platform (NBFC-P2P) | Providing an online platform to bring lenders and borrowers together to help mobilise funds  |

## DEFINITIONS OF NBFCs UNDER VARIOUS DIRECTIONS ISSUED BY RESERVE BANK

**“Systemically important non-deposit taking non-banking financial company”**, means a non-banking financial company not accepting / holding public deposits and having total assets of Rs. 500 crore and above as shown in the last audited balance sheet;

**“Infrastructure Finance Company”** means a non-deposit taking NBFC that fulfills the following criteria:

- (a) a minimum of 75 per cent of its total assets deployed in “infrastructure loans”;
- (b) Net owned funds of Rs. 300 crore or above;
- (c) minimum credit rating 'A' or equivalent of CRISIL, FITCH, CARE, ICRA, Brickwork Rating India Pvt. Ltd. (Brickwork) or equivalent rating by any other credit rating agency accredited by the Bank;
- (d) CRAR of 15 percent (with a minimum Tier I capital of 10 percent).

**“Investment and Credit Company - (NBFC-ICC)”** means any company which is a financial institution carrying on as its principal business - asset finance, the providing of finance whether by making loans or advances or otherwise for any activity other than its own and the acquisition of securities; and is not any other category of NBFC as defined by the Bank in any of its Master Directions

**“Non-Banking Financial Company - Factor (NBFC-Factor)”** means a nonbanking financial company as defined in clause (f) of section 45-I of the RBI Act, 1934 which has its principal business as defined in paragraph 40 of these directions and has been granted a certificate of registration under sub-section (1) of section 3 of the Principal Business: An NBFC-Factor shall ensure that its financial assets in the factoring business constitute at Factoring Regulation Act, 2011.

least 50 per cent of its total assets and its income derived from factoring business is not less than 50 per cent of its gross income.

**“Non-Banking Financial Company – Micro Finance Institution (NBFC-MFI)”** means a non-deposit taking NBFC (other than a company formed and registered under section 25 of the Companies Act, 1956) that fulfils the following conditions: (a) Minimum Net Owned Funds of Rs. 5 crore. (For NBFC-MFIs registered in the North Eastern Region of the country, the minimum NOF requirement shall stand at Rs. 2 crore). (b) Not less than 85% of its net assets are in the nature of “qualifying assets.” (Only the assets originated on or after January 1, 2012 shall have to comply with the Qualifying Assets criteria. As a special dispensation, the existing assets as on January 1, 2012 shall be reckoned towards meeting both the Qualifying Assets criteria as well as the Total Net Assets criteria. These assets shall be allowed to run off on maturity and shall not be renewed).

**“Infrastructure Debt Fund-Non-Banking Financial Company” or “IDF-NBFC”** means a non-deposit taking NBFC that has Net Owned Fund of ` 300 crore or more and which invests only in Public Private Partnerships (PPP) and post commencement operations date (COD) infrastructure projects which have completed at least one year of satisfactory commercial operation and becomes a party to a Tripartite Agreement.

**Core Investment Company (CIC)**, that is to say, a non-banking financial company carrying on the business of acquisition of shares and securities and which satisfies the following conditions as on the date of the last audited balance sheet:-

- (i) it holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, bonds, debentures, debt or loans in group companies;

- (ii) its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trust only as sponsor constitute not less than 60% of its net assets as mentioned in clause (i) above;

Provided; that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time.

- (iii) it does not trade in its investments in shares, bonds, debentures, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
- (iv) it does not carry on any other financial activity referred to in Section 45I(c) and 45I (f) of the Reserve Bank of India Act, 1934 except
- (a) investment in
- (i) bank deposits,
  - (ii) money market instruments, including money market mutual funds and liquid mutual funds
  - (iii) government securities, and
  - (iv) bonds or debentures issued by group companies,
- (b) granting of loans to group companies and
- (c) issuing guarantees on behalf of group companies.

**“Systemically important Core Investment Company (CIC-ND-SI)”** means a core investment company having total assets of not less than Rs.100 crore either individually or in aggregate along with other CICs in the Group and which raises or holds public funds.

**Residuary Non-Banking Company** is a class of NBFC which is a company and has as its principal business the receiving of deposits, under any scheme or arrangement or in any other manner and not being Investment, Asset Financing, Loan Company. These companies are required to maintain investments as per directions of RBI, in addition to liquid assets. The functioning of these companies is different from those of NBFCs in terms of method of mobilization of deposits and requirement of deployment of depositors' funds as per Directions. Besides, Prudential Norms Directions are applicable to these companies also.

## DIFFERENCE BETWEEN BANKS & NBFCs

NBFCs lend and make investments and hence their activities are akin to that of banks; however there are a few differences as given below:

- (i) NBFC cannot accept demand deposits;
- (ii) NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself;
- (iii) deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

## RETURNS TO BE SUBMITTED BY DEPOSIT TAKING NBFCs

- **NBS-1** Quarterly Returns on deposits in First Schedule.
- **NBS-2** Quarterly return on Prudential Norms is required to be submitted by NBFC accepting public deposits.
- **NBS-3** Quarterly return on Liquid Assets by deposit taking NBFC.
- **NBS-4** Annual return of critical parameters by a rejected company holding public deposits. (NBS-5 stands withdrawn as submission of NBS 1 has been made quarterly.)
- **NBS-6** Monthly return on exposure to capital market by deposit taking NBFC with total assets of ` 100 crore and above.

- **Half-yearly ALM return** by NBFC holding public deposits of more than Rs. 20 crore or asset size of more than Rs. 100 crore
- Audited Balance sheet and Auditor's Report by NBFC accepting public deposits.
- Branch Info Return.

### RETURNS TO BE SUBMITTED BY NBFC-ND-SI

- **NBS-7** A Quarterly statement of capital funds, risk weighted assets, risk asset ratio etc., for NBFC-ND-SI.
- Monthly Return on Important Financial Parameters of NBFCs-ND-SI.
- ALM returns:
- Statement of short term dynamic liquidity in format ALM [NBS-ALM1] -Monthly,  
(ii) Statement of structural liquidity in format ALM [NBS-ALM2] Half yearly,  
(ii) Statement of Interest Rate Sensitivity in format ALM -[NBS-ALM3], Half yearly
- Branch Info return

### LESSON ROUND-UP

- The Reserve Bank of India is entrusted with the responsibility of regulating and supervising the Non-Banking Financial Companies by virtue of powers vested in Chapter III B of the Reserve Bank of India Act, 1934.
- A Non-Banking Financial Company (NBFC) is a company registered under the Companies Act, engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property.
- The Reserve Bank has been given the powers under the RBI Act 1934 to register, lay down policy, issue directions, inspect, regulate, supervise and exercise surveillance over NBFCs that meet the 50-50 criteria of principal business.
- The Reserve Bank can penalize NBFCs for violating the provisions of the RBI Act or the directions or orders issued by RBI under RBI Act.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. What is a Non-Banking Financial Company (NBFC)?
2. State the Types/Categories of NBFCs registered with RBI.
3. Is it necessary that every NBFC should be registered with RBI?
4. What are the requirements for registration of NBFC with RBI?
5. Define Infrastructure Finance Company?



## Lesson 11

# Special Economic Zones Act, 2005

### ***Key Concepts One Should Know***

- Special Economic Zone (SEZ)
- Offshore Banking Unit
- Developer
- International Financial Services Centre (IFSC)

### ***Learning Objectives***

#### **To understand:**

- Establishment of Special Economic Zones
- Approval and Authorization to Operate SEZ
- Setting up of Unit
- Domestic Tariff Area
- Special Economic Zone Authority

### ***Regulatory Framework***

- Special Economic Zones Act, 2005
- Special Economic Zones Rules, 2006

### ***Lesson Outline***

- Objective of SEZ Act, 2005
- Salient Features of the SEZ Act, 2005
- Developers – Infrastructure Facilities
- International Financial Service Centre
- Establishment of SEZ
- Guidelines for notifying SEZ
- Board of Approval
- Development Commissioner
- Setting of Unit
- Offshore Banking Unit
- SEZ Authority
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

While the policy relating to the Special Economic Zones is contained in the Foreign Trade Policy, incentives and other facilities offered to the Special Economic Zone developer and units are implemented through various notifications and circulars issued by the concerned Ministries/Departments. The system, therefore, did not lend enough confidence for investors to commit substantial funds for development of infrastructure and for setting up of the units in the Zones for export of goods and services. In order to give a long term and stable policy framework with minimum regulatory regime and to provide expeditious and single window clearance mechanism, the Government enacted Special Economic Zones Act, 2005.

The salient features of the Act are as under:—

- (i) matters relating to establishment of Special Economic Zone and for setting up of units therein, including requirements, obligations and entitlements;
- (ii) matters relating to requirements for setting up of off-shore banking units and units in International Financial Service Center in Special Economic Zone, including fiscal regime governing the operation of such units;
- (iii) the fiscal regime for developers of Special Economic Zones and units set up therein;
- (iv) single window clearance mechanism at the Zone level;
- (v) establishment of an Authority for each Special Economic Zone set up by the Central Government to impart greater administrative autonomy; and
- (vi) designation of special courts and single enforcement agency to ensure speedy trial and investigation of notified offences committed in Special Economic Zones.

## DEFINITIONS

Section 2 of the Act contains definitions of the terms used in the Act.

**“Co-Developer”** means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (12) of Section 3. [Section 2(f)]

**“Developer”** means a person who, or a State Government which, has been granted by the Central Government a letter of approval under sub-section (10) of Section 3 and includes an Authority and a Co-Developer. [Section 2(g)]

**“Export” means—**

- (i) taking goods, or providing services, out of India, from a Special Economic Zone, by land, sea or air or by any other mode, whether physical or otherwise; or
- (ii) supplying goods, or providing services, from the Domestic Tariff Area to a Unit or Developer; or
- (iii) supplying goods, or providing services, from one Unit to another Unit or Developer, in the same or different Special Economic Zone. [Section 2(m)]

**“Import” means—**

- (i) bringing goods or receiving services, in a Special Economic Zone, by a Unit or Developer from a place outside India by land, sea or air or by any other mode, whether physical or otherwise; or
- (ii) receiving goods, or services by a Unit or Developer from another Unit or Developer of the same Special Economic Zone or a different Special Economic Zone. [Section 2(o)]

**“Infrastructure facilities”** means industrial, commercial or social infrastructure or other facilities necessary for the development of a Special Economic Zone or such other facilities which may be prescribed. [Section 2(p)]

**“International Financial Services Centre”** means an International Financial Services Centre which has been approved by the Central Government under sub-section (1) of Section 18. [Section 2(q)]

**"Manufacture"** means to make, produce, fabricate, assemble, process or bring into existence, by hand or by machine, a new product having a distinctive name, character or use and shall include processes such as refrigeration, cutting, polishing, blending, repair, remaking, re-engineering and includes agriculture, aquaculture, animal husbandry, floriculture, horticulture, pisciculture, poultry, sericulture, viticulture and mining. [Section 2(r)]

**"Offshore Banking Unit"** means a branch of a bank located in a Special Economic Zone and which has obtained the permission under clause (a) of sub-section (1) of Section 23 of the Banking Regulation Act, 1949. [Section 2(u)]

**"Person"** includes an individual, whether resident in India or outside India, a Hindu undivided family, co-operative society, a company, whether incorporated in India or outside India, a firm, proprietary concern, or an association of persons or body of individuals, whether incorporated or not, local authority, trust or any entity as may be notified by the Central Government and any agency, office or branch owned or controlled by such individual, Hindu undivided family, co-operative, association, body, authority, company, trust or entity. [Section 2(v)]

**"Services"** means such tradable services which.—

- (i) are covered under the General Agreement on Trade in Services annexed as IB to the Agreement establishing the World Trade Organisation concluded at Marrakesh on the 15th day of April, 1994;
- (ii) may be prescribed by the Central Government for the purposes of this Act; and
- (iii) earn foreign exchange. [Section 2(z)]

#### **What is Special Economic Zone?**

**Special Economic Zone (SEZ) is a specifically delineated duty free enclave and shall be deemed to be foreign territory for the purposes of trade operations and duties and tariffs.**

### **Establishment of Special Economic Zone**

Section 3 of the Act provides that the Central Government, State Government, or any other person, jointly or severally, may establish a Special Economic Zone. Any person who, intends to set up a Special Economic Zone, may, after identifying the area, make a proposal to the State Government concerned for the purposes of setting up a Special Economic Zone. It also allows a person, at his option to make a proposal directly to the Board for the purpose of setting up Special Economic Zone. In cases where such proposal has been received directly from a person, the Board may grant approval and after receipt of such approval, the person concerned, is required to obtain the concurrence of the State Government within prescribed time.

In case a State Government intends to set up the Special Economic Zone, it may after identifying the area, forward the proposal directly to the Board of Approval for setting up of Special Economic Zone. However, the Central Government has been empowered to set up and notify the Special Economic Zone without consulting the State Government concerned; without referring the proposal to the Board.

The State Government may, on receipt of the proposal for setting up a Special Economic Zone forward the proposal together with its recommendations to the Board of Approval within the specified time. The Board of Approval may, after receipt of the proposal for setting up a Special Economic Zone either approve the proposal or, approve the proposal subject to such terms and conditions as it may deem fit to impose. It can also modify or reject the proposal for setting up a Special Economic Zone.

The Central Government has been empowered to specify the minimum area of land for setting up a Special Economic Zone and other terms and conditions subject to which the Board may approve, modify or reject any such proposal received by it. Section 3(9) further provides that if the Board approves the proposal without any modification, it shall communicate the same to the Central Government. If it approves the proposal with modification, it shall, communicate the same to the person or the State Government concerned if the modifications are accepted by the person or State Government, the Board of Approval shall communicate the approval to the Central Government. If it rejects the proposal, it shall record the reasons therefor and communicate the rejection to the person or the State Government concerned.

Section 3(10) requires the Central Government to grant on receipt of communication from the Board of Approval, a letter of approval on such terms and conditions and obligations and entitlements, as approved by Board of Approval, to the person or the State Government concerned. However the Central Government may, on the basis of approval of the Board, approve more than one developer in one Special Economic Zone in cases where one Developer does not have in his possession the minimum area of contiguous land, as may be prescribed, for setting up a Special Economic Zone. In all such cases, each Developer is considered as a Developer in respect of the land in his possession.

This section also provides that any person or a State Government, who intends to provide any infrastructure facilities in the identified area or undertaken any authorised operations may, after entering into an agreement with the Developer, make a proposal for the same to the Board of Approval, for its approval. Every such person or State Government, whose proposal has been approved by the Board and who, or which, has been granted letter of approval by the Central Government, shall be considered a Co-Developer of the Special Economic Zone.

***Who can set up SEZs?***

***Any private/public/joint sector or State Government or its agencies can set up Special Economic Zone (SEZ)***

**Establishment, Approval and Authorization to Operate Special Economic Zone**

Section 4 of the SEZ Act requires the Developer to submit, after the grant of letter of approval, the exact particulars of the identified area to the Central Government which after satisfying that the specified requirements are fulfilled, notify the specifically identified area in the State as a Special Economic Zone. However, the Central Government has been empowered to notify any additional area as a part of a Special Economic Zone. This section empowers the Central Government to authorise the Developer to undertake such operations in a Special Economic Zone, as it may prescribe.

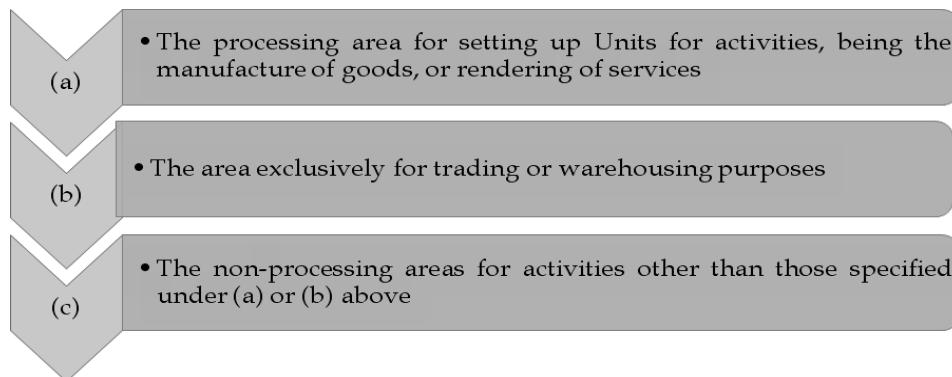
**Guidelines for notifying Special Economic Zone**

*Section 5 stipulates broader guidelines to be considered by the Central Government, while notifying any area as a Special Economic Zone or an area to be included in the SEZ and in discharging its functions under the Act. These include:*

- (a) generation of additional economic activity;
- (b) promotion of exports of goods and services;
- (c) promotion of investment from domestic and foreign sources;
- (d) creation of employment opportunities;
- (e) development of infrastructure facilities; and
- (f) maintenance of sovereignty and integrity of India, the security of the State and friendly relations with foreign States

**The Processing and Non-Processing areas**

Section 6 empowers the Central Government or any specified authority to demarcate the areas falling within the Special Economic Zones as –



### Exemption from taxes, duties or cess

Section 7 exempts all goods or services exported out of, or imported into, or procured from the Domestic Tariff Area, by a Unit or Developer in a Special Economic Zone from the payment of taxes, duties or cess under all enactments specified in the First Schedule. The enactments specified in the First Schedule generally relate to levy and payment of cess.

### Constitution of Board of Approval

Section 8 empowers the Central Government to constitute, by notification, the Board of Approval within fifteen days of the commencement of the Act. This section also provides for composition of Board, term of office of Members, co-option of certain persons as Members of the Board, its meetings and quorum, etc.

### Duties, powers and functions of Board of Approval

Section 9 casts upon the Board the duty to promote and ensure orderly development of the Special Economic Zones.

The powers and functions of the Board, inter alia, include:

- (a) granting of approval or rejecting proposal or modifying such proposals for establishment of the Special Economic Zones;
- (b) granting approval of authorised operations to be carried out in the Special Economic Zones by the Developer;
- (c) granting of approval to the Developers or Units (other than the Developers or the Units which are exempt from obtaining approval under any law or by the Central Government) for foreign collaborations and foreign direct investments (including investments by a person resident outside India) in the Special Economic Zone for its development, operation and maintenance;
- (d) granting of approval or rejecting proposal for providing infrastructure facilities in a Special Economic Zone or modifying such proposals;
- (e) granting a licence to an industrial undertaking referred to in section 3(d) of IDR Act, if such undertaking is established, as a whole or part thereof, or proposed to be established, in a Special Economic Zone;
- (f) suspension of the letter of approval granted to a Developer and appointment of an Administrator under Section 10(1) of the Act;
- (g) disposing of appeals preferred under Section 15(4) and Section 16(4) of the Act;
- (h) performing such other functions as may be assigned to it by the Central Government.

Section 9(3) empowers the Board of Approval to delegate such powers and functions as it may deem fit to one or more Development Commissioners for effective and proper discharge of the functions of the Board. Section 9(5) stipulates that the Board in exercise of its powers and performance of its functions be bound by such directions on questions of policy, as the Central Government may give in writing to it from time to time.

## Suspension of letter of approval and transfer of Special Economic Zone in certain cases

Section 10 empowers the Board to suspend the letter of approval granted to the Developer for a whole or part of his area established as Special Economic Zone for a period not exceeding one year and appoint an Administrator to discharge the functions of the developer in accordance with the terms and conditions of the letter of approval and manage the Special Economic Zone accordingly. The suspension may be ordered by the Board, if in its opinion following circumstances exist:



|  |
|--|
| The developer is unable to discharge the functions or perform the duties imposed on him  |
| The developer has persistently defaulted in complying with the directions of the Board   |
| The developer has violated the terms and conditions of the letter  |
| The financial position of the developer is such that he is unable to fully and efficiently discharge the duties and obligations imposed on him by the letter of approval |
|  |
|  |

However, no letter of approval can be suspended unless the Board has given to the Developer not less than three months' notice, in writing, stating the grounds on which it proposes to suspend the letter of approval, and has considered any cause shown by the Developer within the period of that notice, against the proposed suspension.

It has been further provided that the Board may, instead of suspending the letter of approval permit it to remain in force subject to such further terms and conditions as it thinks fit to impose. Section 10(4) makes any further terms or conditions so imposed binding upon the Developer. These terms and conditions have the force and effect as if they were contained in the letter of approval.

In case the Board suspends a letter of approval, it has been put under obligation to serve a notice of suspension upon the Developer and fix a date for suspension to take effect. Upon suspension of the letter of approval, the Special Economic Zone of the Developer vests in the Administrator for a period not exceeding one year or up to the date on which the letter of approval for such Special Economic Zone is transferred, whichever is earlier. This section also contains provisions for transfer of the Special Economic Zone of a Developer whose licence has been suspended and take other actions consequent upon the suspension of the letter of approval. The Board of Approval has been empowered to issue such directions or formulate such scheme as it may consider necessary for operation of such Special Economic Zone.

## Development Commissioner

Section 11 empowers the Central Government to appoint the Development Commissioner for one or more Special Economic Zones and such Officers and other employees as it considers necessary to assist every Development Commissioner. It also contains provisions for salary and allowances and other terms and conditions of service in respect of leave, pension, provident fund and other matters of the Development Commissioner, officers and other employees.

## Functions of the Development Commissioner

Section 12 dealing with the functions of the Development Commissioner requires every Development Commissioner to take steps in order to discharge his functions to ensure speedy development of the Special Economic Zone and promotion of exports therefrom.

The functions of the Development Commissioner include :

- (a) guide the entrepreneurs for setting up of Units in the Special Economic Zone;
- (b) ensure and take suitable steps for effective promotion of exports from the Special Economic Zone;
- (c) ensure proper coordination with the Central Government or State Government Departments concerned or agencies with respect to, or for above purposes;
- (d) monitor the performance of the Developer and the Units in SEZ;
- (e) discharge such other functions as may be assigned to him by the Central Government under this Act or any other law for the time being in force; and
- (f) any other functions as may be delegated to him by the Board of approval.

This section entitles the Development Commissioner to be overall in charge of the Special Economic Zone and to exercise administrative control and supervision over the officers and employees. Every Development Commissioner is also required to discharge such functions and exercise such powers as may be delegated to him by a general or special order by the Central Government or the State Government concerned, as the case may be. The section further empowers the Development Commissioner to call for such information from a Developer or Unit from time to time as may be necessary to monitor the performance of the Developer and the Unit. The Development Commissioner has been authorised to delegate any or all of his powers or functions to any of the officers employed under him.

### Constitution of Approval Committee

Section 13 empowers the Central Government to constitute by notification, a Committee for every Special Economic Zone, to be called the Approval Committee to exercise the powers and perform the functions as specified. In the case of existing Special Economic Zones, the Approval Committee is required to be constituted within six months from the date of commencement of the Act and in case of other Special Economic Zones established after the commencement of the Act within six months from the date of establishment of such Special Economic Zone. This section also contains provisions relating to composition of meetings and its quorum and requires all orders and decisions and instructions of the Approval Committee to be authenticated by the signature of the Chairperson or any other Member as may be authorised by the Approval Committee.

### Powers and Functions of Approval Committee

Section 14 empowers every Approval Committee to discharge the functions and exercise the powers in respect of the following matters:

- (a) approve, the import or procurement of goods from the Domestic Tariff Area, for carrying on the authorised operations by a Developer in the Special Economic Zone;
- (b) approve providing of services by a service provider from outside India or from the Domestic Tariff Area for carrying on the authorised operations by the Developer, in the Special Economic Zone;
- (c) monitor the utilisation of goods or services or warehousing or trading in the Special Economic Zone;
- (d) approve, modify or reject proposals for setting up Units for manufacturing or rendering of services or warehousing or trading in SEZ in accordance with the provisions of Section 15(8) of the Act;
- (e) allow on receipt of approval foreign collaborations and foreign direct investments, including investments by a person outside India for setting up a Unit;
- (f) monitor and supervise compliance of conditions subject to which the letter of approval or permission, if any, is granted to the Developer or entrepreneur; and
- (g) perform any other functions as may be entrusted to it by the Central Government or the State Government concerned, as the case may be.

In case the developer is Central Government, the approval committee has been empowered to exercise all powers of the approval committee, until the constitution of Approval Committee.

## Setting up of Unit

Section 15 entitles any person, who intends to set up a Unit for carrying on the authorised operations in a Special Economic Zone, to submit a proposal to the Development Commissioner concerned. The Development Commissioner in turn place the proposal before the Approval Committee for its approval. The Approval Committee may, approve the proposal with or without modification, and subject to such terms and conditions as it may deem fit, or reject the same. In case of modification or rejection of a proposal, the Approval Committee has been put under obligation to afford a reasonable opportunity of being heard to the person concerned and after recording the reasons therefor, either modify or reject the proposal. Sub-section (4) entitles a person aggrieved by an order of the Approval Committee, to make an appeal to the Board of Approvals, within the prescribed time and specified manner. Sub-section (8) empowers the Central Government to prescribe the requirements (including the period for which a unit may be set up) subject to which the Approval Committee may approve, modify or reject the proposal. The Development Commissioner may, after the approval of the proposal, grant a letter of approval to the person concerned to set up a Unit and undertake in the Unit such operations which the Development Commissioner may authorise and every such operation so authorised is mentioned in the letter of approval.

## Cancellation of letter of approval granted to entrepreneur

Section 16 empowers the Approval Committee to cancel the letter of approval of an entrepreneur after reasonable opportunity of being heard has been afforded to the entrepreneur. The Approval Committee may, at any time, cancel the letter of approval if it has any reason or cause to believe that the entrepreneur has persistently contravened any of the terms and conditions or its obligation subject to which the letter of approval was granted to the entrepreneur. It further provides that where the letter of approval has been cancelled, the Unit shall not, from the date of such cancellation, be entitled to any exemption, concession, benefit or deduction available to it as such and such Unit shall remit the exemption, concession, drawback and any other benefit availed by the entrepreneur in respect of the capital goods, finished goods lying in the stock and unutilised raw materials in the prescribed manner. Sub-section (4) entitles any person aggrieved from an order of the Approval Committee to make an appeal to the Board of Approval within the prescribed time.

## Setting up and operation of Offshore Banking Unit

Section 17 dealing with setting up and operation of offshore Banking Unit provides that an application for setting up and operation of an Offshore Banking Unit in a Special Economic Zone may be made to the Reserve Bank, in the prescribed form and manner. The Reserve Bank of India may, on being satisfied that the applicant fulfills all the specified conditions, grant permission to such applicant for setting up and operation of an Offshore Banking Unit in a Special Economic Zone. Sub-section (3) empowers the Reserve Bank to specify, by notification, the terms and conditions subject to which an Offshore Banking Unit may be set up and operated in the Special Economic Zone.

*What do you mean by Offshore Banking Unit?*

***“Offshore Banking Unit” means a branch of a bank located in a Special Economic Zone and which has obtained the permission under clause (a) of sub-section (1) of Section 23 of the Banking Regulation Act, 1949.***

## Setting up of International Financial Services Centre

Section 18 empowers the Central Government to approve setting up of an International Financial Services Centre in a Special Economic Zone and to specify requirements for setting up the operation of such Centre. However, the Central Government may approve only one international Financial Services Centre in a Special Economic Zone. The Central Government may subject to the guidelines as may be framed by the Reserve Bank, the Security and Exchange Board of India, the Insurance Regulatory and Development Authority and such other authority as it may deem fit, prescribe the requirement for setting up and terms and conditions of the operation of International Financial Services Center.

## **Single application form, return, etc.**

Section 19 empowers the Central Government to prescribe single application form for obtaining any licence, permission or registration or approval by a Developer or an entrepreneur under one or more Central Acts. Section 19(b) empowers the Central Government to authorise the Board, the Development Commissioner and the approval Committee to exercise its powers on matters relating to the development of SEZ or setting up or operation of units. Section 19(c) empowers the Central Government to prescribe single form for furnishing returns or information by a developer or an entrepreneur under one or more Central Acts.

## **Agency to inspect**

Section 20 empowers the Central Government to specify, by notification, any officer or agency for carrying out surveys or inspections for securing the compliance with the provisions of any Central Act by a Developer or an entrepreneur, as the case may be, and such officer or agency is required to submit verification or compliance report, in such manner and within such time as may be specified in the said notification.

## **Single enforcement officer or agency for notified offences**

Section 21 empowers the Central Government to specify by notification, any act or omission made punishable under any Central Act, as notified offence for purposes of the proposed legislation. It further empowers the Central Government to authorise any officer or agency to be the enforcement officer or agency in respect of any notified offence committed in a Special Economic Zone. Every officer or agency so authorised has been granted all the corresponding powers of investigation, inspection, search or seizure as provided under the relevant Central Act in respect of the notified offences.

## **Investigation, Inspection, Search or Seizure**

Section 22 empowers the agency or officer, with prior intimation to the Development Commissioner concerned to carry out the investigation, inspection, search or seizure in the Special Economic Zone or in a Unit if such agency or officer has reason to believe (reasons to be recorded in writing) that a notified offence has been committed or is likely to be committed in the Special Economic Zone. However, no investigation, inspection, search or seizure is allowed to be carried out in a SEZ by any agency or officer other than those referred to in Section 21(2) or (3), without prior intimation or approval of the concerned Development Commissioner. It is further provided that an officer or agency, if so authorised by the Central Government, may carry out the investigation, inspection, search or seizure in the Special Economic Zone or Unit without prior intimation or approval of the Development Commissioner.

## **Designated Courts to try suits and notified offences**

Section 23 empowers the concerned State Government, in which SEZ is situated, to designate, with the concurrence of the Chief Justice of the High Court of that State, one or more Courts to try all suits of a civil nature arising out of offences committed in the Special Economic Zone. Section 23(2) provides that no court, other than the designated court shall try any suit or conduct the trial of any notified offence.

## **Appeal to High Court**

Section 24 entitles any person aggrieved by any decision or order of the designated Court to file an appeal to the High Court within sixty days from the date of communication of the decision or order of the said court to him on any question of fact or law arising out of such orders. However the High Court can, if it is satisfied that the appellant was prevented by sufficient cause from filing an appeal within the prescribed period of sixty days allow it to be filed within a further period not exceeding sixty days.

## **Offences by Companies**

Section 25 dealing with offences by companies provides that where an offence has been committed by a company, every person who at the time the offence was committed was in charge of and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly. However such person shall not be liable to any

punishment if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Section 25(2) provides that where an offence has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall, also be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

### **Exemptions, drawbacks and concessions to every Developer and entrepreneur**

Section 26 contains provisions relating to exemptions, drawbacks and concessions to Developer and entrepreneur from any duty of customs under the Customs Act, 1962, the Customs Tariff Act, 1975, the Central Excise Act, 1944 or the Central Excise Tariff Act, 1985 or any other law for the time being in force, exemption from the service tax under Chapter V of the Finance Act, 1994 and exemption from levy of taxes on sale or purchase of goods other than newspapers under the Central Sales Tax Act, 1956 if such goods are meant to carrying on authorised operations by the developer or entrepreneur. The developer or entrepreneur has also been entitled to drawback or such other benefits as may be admissible from time to time on goods brought or services provided from DTA into SEZ or unit or services provided in SEZ or unit by service providers located outside India to carry on the authorised operations by the Developer or entrepreneur. The Central Government has also been empowered to specify the manner in which and the terms and conditions subject to which, the exemptions, concessions, drawbacks or other benefits are to be granted to developer or entrepreneur.

### **Application of the provisions of the Income Tax Act, 1961 with certain modifications in relation to Developers and entrepreneurs**

Section 27 provides for application of the provisions of the Income Tax Act, 1961 to the Developer and entrepreneur for carrying on the authorised operations in the Special Economic Zones or Unit subject to modifications specified in the second schedule.

### **Duration of goods & services in Special Economic Zones**

Section 28 empowers the Central Government to specify, the period during which any goods brought into, or services provided in, any Unit or Special Economic Zone without payment of taxes, duties, levies or cess, shall remain or continue to be provided in such Unit or Special Economic Zone.

### **Transfer of ownership and removal of goods**

Section 29 allows the transfer of ownership in any goods brought into, or produced or manufactured in, any Unit or Special Economic Zone or removal thereof from such Unit or Zone, subject to such terms and conditions as specified by the Central Government.

### **Domestic clearance by Units**

Section 30 provides that any goods removed from a Special Economic Zone to the Domestic Tariff Area be chargeable to duties of customs including anti-dumping, countervailing and safeguard duties under the Customs Tariff Act, 1975, where applicable, as leviable on such goods when imported. This section further provides that the rate of duty and tariff valuation, if any, applicable to goods removed from a Special Economic Zone shall be at the rate and tariff valuation in force as on the date of such removal, and where such date is not ascertainable, on the date of payment of duty. This section empowers the Central Government to make rules specifying conditions in this regard.

### **Special Economic Zone Authority**

Section 31 dealing with the Constitution of Authority empowers the Central Government to constitute by notification in the Official Gazette, an Authority for every SEZ to exercise powers conferred on and discharge the functions assigned to it.

In the case of an existing SEZ established by the Central Government the Central Government has been empowered to establish such authority within six months from the date of commencement of the Act. It is further provided that

the person or authority (including Development Commissioner) which is exercising control over an existing SEZ, shall continue to do so till the authority is constituted. Section 31(2) provides that every authority shall be a body corporate by name as assigned, having perpetual succession and a common seal, with power to acquire, hold and dispose of property, both movable and immovable and to contract and shall sue and be sued. Section 31(9) stipulates that no act or proceedings of an authority shall be invalidated merely by reason of:

- (a) any vacancy in or any defect;
- (b) any defect in the appointment of a person as its member; or
- (c) any irregularity in the procedure of the authority not affecting the merits of the case.

### Functions of Authority

Section 34 casts upon the Authority a duty to undertake such measures as it thinks fit for the development, operation and management of the respective Special Economic Zone. Section 34(2) provides for following measures :

- (a) the development of infrastructure in the Special Economic Zone;
- (b) promoting exports from the Special Economic Zone;
- (c) reviewing the functioning and performance of the Special Economic Zone;
- (d) levy user or service charges or fees or rent for the use of properties belonging to the Authority;
- (e) performing such other functions as may be prescribed.

### Directions by the Central Government

Section 38 empowers the Central Government to give directions to the authority and makes it binding for every Authority of the Special Economic Zone to carry out the directions issued from time to time in this regard.

### Returns and reports by the Authority

Section 39 casts upon every Authority of the Special Economic Zone a duty to furnish to the Central Government such returns and statements and such particulars in regard to the promotion and development of exports and the operation and maintenance of the Special Economic Zone and Units as it may require from time to time. This section further requires every authority to submit to the Central Government after the end of each financial year a report in form and before specified date, giving a true and full account of its activities, policy and programmes during the previous financial year. Section 39(3) requires a copy of every such report to be laid before each House of Parliament, soon after its receipt

### Power of the Central Government to Supersede Authority

Section 40 empowers the Central Government to supersede an Authority for a maximum period of six months if at any time, it is of the opinion that an Authority is unable to perform, or has persistently made default in the performance of the duty imposed on it or has exceeded or abused its powers, or has wilfully or without sufficient cause, failed to comply with any direction issued by it. However, before issuing a notification superseding an authority, the Central Government is required to give reasonable time to that Authority to make representation against the proposed suppression and consider the representations, if any, of the Authority. Section 40(2) dealing with the consequences of publication of the notification superseding the Authority, provides that,

- (a) the Chairperson and other Members of the Authority shall, notwithstanding that their term of office has not expired as from the date of supersession, vacate their offices as such;
- (b) all the powers, functions and duties which may, by or under the provisions of the Act, be exercised or discharged by or on behalf of the Authority shall, during the period of supersession, be exercised and performed by such person or persons as the Central Government may direct;
- (c) all property vested in the Authority shall, during the period of supersession, vest in the Central Government.

Section 40(3) also provides that on the expiration of the period of supersession specified in the notification, the Central Government may extend the period of supersession for such further period not exceeding six months or reconstitute the Authority in the prescribed manner.

## Reference of Dispute and Limitation

Section 42 requires any dispute of civil nature arising among two or more entrepreneurs or two or more Developers or between the entrepreneur and Developer in the Special Economic Zone to be referred to arbitration provided, the court or the courts to try suits in respect of such dispute had not been designated. However no dispute should be referred to the arbitration on or after the date of the designation of court or courts under section 23(1). It further provides that where a dispute has been referred to arbitration, the same shall be settled or decided by the arbitrator to be appointed by the Central Government and the provisions of the Arbitration and Conciliation Act, 1996 shall apply to all arbitrations.

Section 43 stipulates that the period of limitation in the case of any dispute which is required to be referred to arbitration shall be regulated by the provisions of the Limitation Act, 1963, as if the dispute was a suit and the arbitrator is civil court. Section 43(2), however, empowers the arbitrator to admit, a dispute after the expiry of the period of limitation, if the arbitrator is satisfied that the applicant had sufficient cause for not referring the dispute within specified period.

## Person to whom a communication to be sent

Section 45 provides that a communication by any competent authority or person may be sent to the person who has the ultimate control over the affairs of the Special Economic Zone or Unit or where the said affairs are entrusted to a manager, director, chairperson, or managing director, or to any other officer, by whatever name called, such communication may be sent to such manager, director, chairperson, or managing director or any other officer.

## Identity card

*Section 46 requires that every person whether employed or residing or required to be present in a Special Economic Zone be provided an identity card by every Development Commissioner in prescribed form and containing specified particulars.*

## Power of the Central Government to modify provisions of the Act or other enactments in relation to Special Economic Zones

Section 49 empowers the Central Government to direct, by notification in the Official Gazette, that any of the provision of the Act or any other Central Act, any rules or regulations made thereunder or any notification or order issued or direction given thereunder specified in the notification shall not apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones; or shall apply to a Special Economic Zone or a class of Special Economic Zones or all Special Economic Zones only with such exceptions, modification and adaptation, as may be specified in the notification. Sub section (2) requires a copy of every notification proposed to be issued to be laid in draft before each House of Parliament. The notification shall not be issued or, as the case may be, shall be issued only in such modified form as may be agreed upon by both the Houses of Parliament.

## Power of State Government to grant exemption

Section 50 empowers the State Government to notify policies for Developers and Units and to take suitable steps for enactment of any law -

- (a) granting exemption from the State taxes, levies and duties to the Developer or the entrepreneur;
- (a) delegating the powers conferred upon any person or authority under any State Act to the Development Commissioner in relation to the Developer or the entrepreneur.

## SEZ Act to have overriding effect

*Section 51 giving overriding effect to this Act provides that the provisions of this Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.*

## Special Economic Zones to be ports, airports inland container depots, land stations etc. in certain cases

Section 53 provides that a Special Economic Zone, on and from the appointed day, be deemed to be a territory outside the customs territory of India for the purposes of undertaking the authorised operations. This section further provides that a Special Economic Zone shall, with effect from such date as the Central Government may notify, be deemed to be a port, airport, inland container depot, land station and land customs stations under section 7 of the Customs Act, 1962. The Central Government has been empowered to notify different dates for different Special Economic Zones.

## Special Economic Zones Rules, 2006

Section 55 empowers the Central Government to make rules in respect of specified matters and requires that the same be published in the Official Gazette and be laid before each House of Parliament. In this context, the Central Government has notified the Special Economic Zones Rules, 2006 on February 10, 2006.

### Rights of appellant to appear before the Board

According to Rules 61 of the Special Economic Zones Rules, 2006 every appellant may appear before the Board in person or authorize one or more chartered accountants or **company secretaries** or cost accountants or legal practitioners or any of his or its officers to present his or its case before the Board.

It may be noted that company secretary means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act.

### LESSON ROUND-UP

- Special Economic Zones (SEZ) are growth engines that can boost manufacturing, augment exports and generate employment. The SEZs require special fiscal and regulatory regime in order to impart a hassle free operational regime encompassing the state of the art infrastructure and support services.
- Special Economic Zone (SEZ) is a specifically delineated duty free enclave and is deemed to be foreign territory for the purposes of trade operations and duties and tariffs.
- SEZ units are governed by Special Economic Zones Act, 2005.
- Central Government, State Government, or any other person, jointly or severally, may establish a Special Economic Zone. Any person who, intends to set up a Special Economic Zone, may, after identifying the area, make a proposal to the State Government concerned for the purposes of setting up a Special Economic Zone.
- Board of Approval granting of approval or rejecting proposal or modifying such proposals for establishment of the Special Economic Zones.
- Every Development Commissioner to take steps in order to discharge his functions to ensure speedy development of the Special Economic Zone and promotion of exports there from.
- The Central Government to constitute by notification, a Committee for every Special Economic Zone, to be called the Approval Committee to exercise the powers and perform the functions as specified.
- Any person, who intends to set up a Unit for carrying on the authorised operations in a Special Economic Zone, to submit a proposal to the Development Commissioner concerned.
- An application for setting up and operation of an Offshore Banking Unit in a Special Economic Zone may be made to the Reserve Bank of India.
- SEZ Act casts upon the SEZ Authority a duty to undertake such measures as it thinks fit for the development, operation and management of the respective Special Economic Zone.
- Every person whether employed or residing or required to be present in a Special Economic Zone shall be provided an identity card by every Development Commissioner in prescribed form and containing specified particulars.

- Provisions of the SEZ Act shall have effect notwithstanding anything inconsistent therewith contained in any other law for the time being in force or in any instrument having effect by virtue of any law other than this Act.
- Any person aggrieved by any decision or order of the designated Court may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the said court to him on any question of fact or law arising out of such orders.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Special Economic Zones are growth engines. Discuss.
2. Discuss in detail the salient features of SEZ Act, 2005.
3. Explain the procedure for establishment of SEZ.
4. Briefly discuss the duties, powers and functions of Board of Approval in respect of Special Economic Zones.
5. What are the functions of Approval Committee under SEZ Act, 2005?

## Lesson 12

# The Competition Act, 2002

### ***Key Concepts One Should Know***

- Competition
- Cartel
- Consumer
- Bidriving
- Enterprise
- Anti-Competitive Agreement
- Dominant Position
- Combination

### ***Learning Objectives***

#### **To understand:**

- Competition Policy
- Anti-Competitive Agreements
- Abuse of Dominant Position
- Overview of Combination
- Regulation of Combinations
- Competition Advocacy
- Competition Commission of India
- Right to Legal Representation

### ***Regulatory Framework***

- Competition Act, 2002
- Competition Commission of India (Procedure in regard to the transaction of business relating to combinations) Regulations, 2011
- Competition Commission of India (Lesser Penalty) Regulations, 2009
- Competition Commission of India (Determination of Cost of Production) Regulations, 2009

### ***Lesson Outline***

- Competition and Economic efficiency
- Competition Law and Policy
- Competition Regime in India
- Anti-Competitive Agreement
- Abuse of Dominant Position
- Combination
- Director General
- Enquiry into Certain Agreements
- Enquiry into Dominant Position of Enterprise
- Enquiry into Combination by Commission
- Competition Commission of India
- Competition Advocacy
- Offences and penalties
- Appeal to Supreme Court
- LESSON ROUND-UP
- TEST YOURSELF

*The Competition Act, 2002 has been enacted to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on competition, to promote and sustain competition in the markets, to protect the interest of consumers and to ensure freedom of trade carried on by other participant in the markets in India and for matters connected therewith or incidental thereto.*

## INTRODUCTION

There is a growing recognition that a flexible, dynamic and competitive private sector is essential to fostering sustained economic development. Promoting effective competition spurs firms to focus on efficiency and improves consumer welfare by offering greater choice of higher-quality products and services at lower prices. It also promotes greater accountability and transparency in government-business relations and decision making, helps reduce corruption, lobbying, and rent seeking. In addition, it provides opportunities for broadly based participation in the economy and for sharing in the benefits of economic growth.

The idea of competition has had, for two centuries or more, a powerful influence on the way we think about our society, the way we organise things and the way we conduct our own economic and personal lives. The competition being an essential element in the efficient working of markets encourages enterprise and efficiency and widens choice. By encouraging efficiency in industry, competition in the domestic market whether between domestic companies alone or between those and overseas companies also contribute to international competitiveness. The full benefits of competition are, however, felt in markets that are open to trade and investment.

Economic theory suggests that prices and quantities in a competitive market equilibrate to levels that generate efficient outcomes at a given point of time. Competition is therefore, beneficial as it provides to consumers wider choice and provides sellers with stronger incentives to minimize costs, so eliminating waste. Competition increases the likelihood that cost savings resulting from efficiency gains will be passed on to a firm's customers, who may be either final consumers or intermediary customers (in which case costs of those firms are also lowered). Ample empirical evidence supports these arguments. The importance of competition for achieving a higher rate of innovation and adoption of new technologies over time is critical for sustaining rapid growth. Yet it is not automatic and is not the same as *laissez faire*.

In fact, there are reasons to believe that less mature markets tend to be more, rather than less, vulnerable to anti-competitive practices than the markets of developed countries. Reasons include: (a) high "natural" entry barriers due to inadequate business infrastructure, including distribution channels, and (sometimes) intrusive regulatory regimes; (b) asymmetries of information in both product and credit markets; and (c) a greater proportion of local (non-tradable) markets. Competition also serves to diffuse socio-economic power, broadening participation in economic, social, and political advances while ensuring opportunities for new entrepreneurs. Moreover, it can facilitate realization of the benefits for the domestic economy of integrating into international trade and investment patterns.

Several studies have demonstrated the stimulating effects of competitive markets in terms of growth and prosperity. William Lewis in his book, *The Power of Productivity* underlines this point forcefully with his observations on the growth of productivity in the late 1990s in the United States. The author has argued that more than technology and other factors, what matters above all is competition. Similarly, economist Paul London in his book, *The Competition Solution* concludes that heightened competition in the US over-shadowed tax cuts or new technologies in explaining the prosperity of the 1990s. Competitive pressures helped suppress inflation and raise living standards through improved productivity. The author noted that competition from imports forced the steel and auto industry, among other manufacturers, to streamline, thereby pushing manufacturing productivity up by 4% a year. Competition has brought down real air fares, telephone rates and several other costs. Where jobs have been lost in one industry, these have been more than compensated by jobs created elsewhere; thus employment has not suffered but has shifted from losers to winners. This argument underlines across the board, the benefits of competition to a wide sections of society, including consumers, workers and many others.

## Definition of Competition

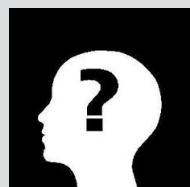
Competition is a complex and technical subject which does not lend itself to easy summary or concise clarification. Of late, with globalisation and opening of the markets worldwide, it has become a subject of great practical importance. It involves the establishment and development of concepts, legal principles and policies for the benefit of consumer interest. The principles and policies are applied to a wide range of private agreements and arrangements, which commercial undertakings enter into for themselves or with each other. In addition, they also apply to the policies and directions of the Government.

In the absence of a generally accepted definition of the phenomenon of competition, it has to be regarded as the object fostered and protected by competition policy and law. The World Bank and OECD in its Report *A Framework for the Design and Implementation of Competition Law and Policy*, broadly defines the competition is “a situation in a market in which firms or sellers independently strive for the buyers’ patronage in order to achieve a particular business objective, for example, profits, sales or market share.”

Competition can also be defined as a process of economic rivalry between market players to attract customers. These market players can be multinational or domestic companies, wholesalers, retailers, or even the neighborhood shopkeeper. In their pursuit to outdo rival enterprises, market players either adopt fair means (producing quality goods, being cost efficient, adopting appropriate technologies, etc.) or indulge in unfair measures (carrying out restrictive business practices – such as predatory pricing, exclusive dealing, tied selling, collusion, cartelisation, abuse of dominant position, etc.). However, in the interest of consumers, and the economy as a whole, it is necessary to promote an environment that facilitates fair competitive outcomes in the market, curb anti-competitive behaviour and discourage market players from adopting unfair measures.

*What is competition in the market?*

In common parlance, competition in the market means sellers striving independently for buyers’ patronage to maximize profit (or other business objectives). A buyer prefers to buy a product at a price that maximizes his benefits whereas the seller prefers to sell the product at a price that maximizes his profit.



## Competition and Economic Efficiency

A number of empirical studies found a positive relationship between competition and innovation, productivity and economic growth. P. Aghion and P. Howitt in *Endogenous Growth Theory* offered several theoretical situations where competition is conducive to innovation – Intensified product market competition could force managers to speed up the adoption of new technologies; Intensive product market competition with incumbent firms engaged in step by step innovative activities could enhance each firms incentive to acquire or increase its technological lead over its rivals and, if labour markets are flexible, competition will induce skilled workers to move to opportunities employing best practices and technologies. Competition also reduces slack by providing more incentives for managers and workers to increase efforts and improve efficiency. Therefore, the product market competition disciplines firms into efficient operation.

Nickel et. al. in his article *Competition and Corporate Performance* suggested three different channels of incentives – competition creates greater opportunities for comparing performance; a more competitive environment where price elasticity of demand tends to be higher, induces greater efforts among workers and managers for cost reducing improvements in productivity since improvements could generate larger increase in revenue and profits; and a more competitive environment forces managers to improve efficiency, because more intense the competition, greater the chances for inefficient to be extinguished.

*UK White Paper on World Class Competition Regime* clearly brings out the importance of competition in an increasingly innovative and globalised economy. Vigorous competition between firms is the lifeblood of strong and effective markets. Competition helps consumers get a good deal. It encourages firms to innovate by reducing slack, putting downward pressure on costs and providing incentives for the efficient organisation of production.

Empirical evidences show that strong competition is closely linked to dynamic and efficient markets. The benefits of competitive forces for economic growth and consumer welfare are widely recognized and evidenced by several studies. Recently, an empirical study in the U.K. by the Centre for Competition Policy, University of East Anglia showed that prices were more than halved through competition in international telephony and airfares, and were significantly reduced in other areas. The survey also brought home the point that competition is not just about prices but is typically multi-faceted, bringing new ways of doing business and leading to technological and other advances.

Michel Porter in his recent work *Can Japan Compete?* shows that in Japan only those sectors characterized by strong domestic competition remain internationally competitive following the country's recent economic downturn, examples include cameras, automobiles and audio equipment. Many leading competition experts believe in the premise that, in the presence of competition, the market will achieve the objective of maximising welfare.

### Competition Law and Policy

The World Bank and OECD in its Report *A Framework for the Design and Implementation of Competition Law and Policy* pointed out that a dynamic and competitive environment, underpinned by sound competition law and policy, is an essential characteristic of a successful market economy. Effective enforcement of competition law and active competition advocacy can also be powerful catalysts for successful economic restructuring. This in turn fosters flexibility and mobility of resources, which in the current global business environment are critical elements for the competitiveness of firms and industries across nations. Although the field of competition law and policy is evolving rapidly and includes many different viewpoints on specific issues, recognition is growing that effective competition law is important in shaping business culture and that its proper implementation needs to allow for the education of business people, government officials, the judiciary, and the interested public.



*The basic purpose of Competition Policy and law is to preserve and promote competition as a means of ensuring efficient allocation of resources in an economy. Competition policy typically has two elements: one is a set of policies that enhance competition in local and national markets. The second element is legislation designed to prevent anti-competitive business practices with minimal Government intervention, i.e., a competition law. Competition law by itself cannot produce or ensure competition in the market unless this is facilitated by appropriate Government policies. On the other hand, Government policies without a law to enforce such policies and prevent competition malpractices would also be incomplete.*

Competition policies cover a much broader set of instruments than competition law and typically include all policies aimed at increasing the intensity of competition or rivalry in local and national markets by lowering entry barriers and opportunities for harmful coordination, to ensure that markets work effectively and serve the interests of all citizens. Competition law is only a subset of a nation's competition policies. Competition policies typically include pro-competition approaches to trade, investment, sectoral regulation, and consumer protection. The barriers to international or interregional trade, restrictions on Foreign Direct Investment (FDI) and technology transfers, restrictions on entry in regulated network utility industries, regulations affecting the registration of new enterprises and the taxation and corporate governance of existing enterprises and rules on marketing practices all influence the extent of competitive pressures in markets and so are appropriate concerns of competition policies. In many countries, competition authorities have become the focal point for consultations and putting forward pro-competition viewpoints across a broad range of policy areas.

Asian Development Bank in "During economic transition or reforms", observed that "the benefits of an open market economy cannot be fully realized unless restrictions on competition are removed. Opening markets is not enough by itself for countries to begin reaping the benefits of competition; firms will still find incentives to engage in anti-competitive practices. Thus, the intended benefits of trade reforms may not be realized without active enforcement of competition law. This highlights the importance of having faith in the benefits of competition from an early stage of economic growth and of incorporating competition policy into the broader economic policy framework."

Prof. Paul Geroski, former Chairman, Competition Commission of the United Kingdom observed that "Competition policy is about ensuring that markets are, and remain, competitive. This brings benefits to consumers eventually in all the ways. However, eliminating anti-competitive practices and dismantling monopoly positions that lead to abuses also benefit firms whose business suffers from these practices and abuses. It is worth emphasizing that many of the benefits that emanate from proper application of competition policy are felt in the first instance by firms. This is important for those who seem to think of competition policy as an added and unnecessary burden on business. Competition policy is sometimes a burden on business, but only on those businesses that try to unfairly disadvantage their rivals in ways that reduce their competitive abilities or incentives to compete vigorously".

Hence, competition policy and competition law need to be distinguished. The former can be regarded as a genus, of which, the latter is specie.

## COMPETITION REGIME IN INDIA

### Historical Perspective

The Indian economy remained subject to controls and regulations for several decades, such as industrial licensing, foreign exchange restrictions, small scale industry protection, control on foreign investment and technologies, quantitative restrictions on imports, administered prices, and control on capital issues. The domestic industry was thus insulated from competition.

The economic consequences of this policy regime, though initially beneficial, were reflected in a poor rate of economic growth, low levels of productivity and efficiency, absence of international competitiveness, sub-optimal size of businesses, and outdated and inefficient technologies in various sectors.

India has therefore witnessed two phases of development process with different policy regimes and institutional frameworks. In the first phase, since independence, the transformation and development of the Indian economy took place within a planned, rigidly regulated and relatively closed economic framework. In the second phase, since 1991, when the country embarked upon reform process and embraced market oriented policies.

In the late 1980s and early 1990s, need for liberalization policies was recognized and a range of policy and regulatory reforms were initiated, such as delicensing of industry, shrinking the monopoly of the public sector industries (other than those where strategic and security concerns dominated), removal of quantitative restrictions on imports, market determined exchange rate, liberalization of foreign direct investment, capital market reforms, liberalizing the financial markets, reduction in small scale industry reservations, and a much greater role for the private sector in infrastructure industries such as power, port, transport and communications.

### Economic Reforms and Competition

The world economy has been experiencing a progressive international economic integration for the last half a century. There has been a marked acceleration in this process of globalisation and also liberalisation during the last three decades.

Since 1991, the Government of India has introduced a series of economic reforms, including policies of liberalisation, deregulation, disinvestment and privatisation. The seriousness of macroeconomic imbalances and unanimity towards reform rendered this possible. The broad thrust of the new policies was a move away from the centralised allocation of resources in some key sectors by the government to allocation by market forces. Private participation in economic development has emerged as an alternative to the state-oriented development strategy in the reform period.

After a decade of reforms, restraints to competition such as state monopolies and protective measures and controls have been replaced by relatively more competitive and de-regulated open market policies. In the post reform period, the private sector participation in production and supply of utility services has increased substantially. Independent regulators have been established for many sectors such as road, power, telecommunications and insurance. These sectoral regulators have been empowered to determine sector specific entry conditions and eventually the level of competition. In nutshell, post reforms period witnessed an open market orientation in industrial policy, foreign trade policy, foreign investment policy and financial sector policy, infrastructure policy, etc.

## Competition Law-Evolution and Development

The first Indian competition law was enacted in 1969 and was christened as the Monopolies and Restrictive Trade Practices Act, 1969 (MRTP Act). The genesis of the MRTP Act, 1969 is traceable to Articles 38 and 39 of the Constitution of India. The Directive Principle of State Policy in those Articles lays down, *inter-alia* that the State shall strive to promote the welfare of the people by securing and protecting as effectively, as it may, a social order in which justice - social, economic and political- shall inform all the institutions of the national life, and the State shall, in particular, direct its policy towards securing:

1. that the ownership and control of material resources of the community are so distributed as best to subserve the common good; and
2. that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

Legal framework dealing with competition in India spread over other legislations, besides the Monopolies and Restrictive Trade Practices Act, 1969, other legislations dealing with competition include Consumer Protection Act, 1986, the Patents Act 1970 etc.

### Background to the MRTP Act, 1969

India, when it became free from the colonial power was industrially very backward. In fact, it inherited an economy in a ravaged condition. Under development of the economy in many respects led the successor Government to adopt a system of planning. In the interest of transformation of the backward industrial economy into an advanced industrial economy, the planners thought it fit to allow the then established industries to develop and grow further. Alongside, mixed economy was also developed as a concept of economic planning. No doubt, there was perceptible growth in industrialisation. However, this also brought on its trails, concentration of wealth and economic power. This led to widening of the difference between the haves and have nots in the society. The Government of India therefore set up the Monopolies Inquiry Commission in 1964 with a view to finding out the causes, the nature and the extent of concentration of economic power in the country and to suggest remedial measures therefor.

The Monopolies Inquiry Commission submitted a detailed report in October 1965 which was well documented and revelatory of many facets of concentration of economic power. Many of the trade practices which were designed to stifle competition in the market and to promote monopolistic tendency were also noticed by the Commission in the course of its inquiry. The Commission observed that there was no need to strike at the concentration of economic power as such but to do so only when it became a menace to the best production in quality and quantity or to fair distribution. Monopolistic conditions in any industrial sphere should be discouraged without injury to the interests of the general public and monopolistic and restrictive trade practices should be curbed except when they were conducive to the common good. The Commission pointed out that on the one hand over the years certain business houses had built vast industrial empires and on the other hand they were trying to accentuate and enlarge the empires by adopting certain trade practices which were intended to distort competition in the market and promote a set of near monopoly conditions. The Commission felt that such tendencies seemed to destroy the basic concept of socio-economic justice enshrined in the Constitution. The Commission also framed a draft Bill as a part of its recommendations.

The Monopolies and Restrictive Trade Practices Bill was introduced in Parliament in 1967 which after being referred to the Joint Select Committee became an Act and finally came into force w.e.f. 1st June, 1970.

The enactment was based on the socio-economic philosophy enshrined in the Directive Principles of State Policy contained in the Constitution which provides that the State shall direct its policy towards securing that the ownership and control of material resources of the community are distributed as best to subserve the common good and that the operation of the economic system does not result in the concentration of wealth and means of production to the common detriment.

The principal objectives of the Act, as spelt out in the preamble were:

- (i) prevention of concentration of economic power to the common detriment;
- (ii) control of monopolies;

- (iii) prohibition of monopolistic trade practice;
- (iv) prohibition of restrictive trade practices.

The MRTP Act, 1969 underwent amendments in 1974, 1980, 1982, 1984, 1986, 1988 and 1991. Major changes introduced in the 1982 and 1984 Amendment Acts were based on the recommendations of the Sachar Committee. The 1984 amendment introduced the concept of unfair trade practice under the Act. Far-reaching changes have been brought about by the 1991 amendment and these were made in the wake of new industrial policy of July, 1991 which is wedded to liberalisation, globalisation and de-regulation.

### Scheme of the MRTP Act

Prevention of undesirable concentration of economic power was sought to be achieved essentially through the regulation of growth of undertakings of particular size, viz. undertakings having assets of the value of `100 crores. These business houses were officially designated as large business houses. Undertakings having a sizable share of the market, or licensed production capacity of more than 1/4th of the total production or installed capacity in India were described as dominant undertakings. These companies were declared large business houses if their assets were of the value of `1 crore or more.

These undertakings were referred to as MRTP undertakings. Such undertakings had to obtain approval of the Central Government to undertake substantial expansion of production, establishment of new undertakings, amalgamate with or takeover any other undertaking. Appointment of persons who were directors in such undertakings as director in any other undertaking needed the approval of the Central Government. The Central Government also had the power to order for division of such undertakings or for severance of interconnection under certain circumstances. Restrictions were placed on the acquisition and transfer of shares of, or by, bodies corporate owning such undertakings.

However, the MRTP (Amendment) Act, 1991 sought to liberalise these restrictions by removing the concept of MRTP undertakings and provisions relating to their substantial expansion, amalgamation etc., and acquisition of shares of, or by, such undertakings etc. The provisions relating to Central Government's power to direct division of undertakings or severance of interconnection have been modified such that they apply to all undertakings (hitherto, they applied only to MRTP undertakings).

Chapter IV deals with monopolistic trade practices indulged in by any undertaking. The Act defines the concept of monopolistic trade practices in terms of unreasonableness of the prices charged, unreasonableness in preventing or lessening competition in the market, unreasonably increasing prices, profits and limiting technical development to the common detriment etc. The remedy for dealing with monopolistic trade practice is an inquiry at the instance of the Central Government by the M.R.T.P. Commission or suo motu by the Commission and suitable orders being passed by the Central Government thereafter to prevent the mischief resulting from such practices.

The Act also deals with matters relating to restrictive trade practices. Briefly stated, a restrictive trade practice is one which prevents, distorts or restricts competition for goods and services in any manner. While unreasonableness is the test for monopolistic trade practices, even a small distortion in competition is sufficient to bring a case under restrictive trade practices. The provisions relating to restrictive trade practices are therefore intended to promote fair and free competition in the market. The Act provides for a scheme of registration of certain agreements relating to restrictive trade practices. The MRTP (Amendment) Act, 1984 introduced new provisions relating to unfair trade practices with a view to promoting the interest of consumers. It is essential to note that the M.R.T.P. Commission has been given full powers to regulate restrictive and unfair trade practices by means of an inquiry and pass final orders thereon. The MRTP Commission may inquire into restrictive and unfair trade practices at the instance of the Central Government, State Government, Director General of Investigation and Registration, registered consumer associations, individual consumer and on its own. The Commission has also powers to grant temporary injunctions and award compensation and punish for contempt under Sections 12A, 12B and 13B of the Act respectively.

The Commission is an independent quasi-judicial body and has powers similar to a Civil Court under the Code of Civil Procedure, 1908 on some matters. The Director General of Investigation and Registration and the Secretary of the Commission assist in the inquiry in respect of monopolistic, restrictive and unfair trade practices. The Commission conducts enquiries and other businesses in accordance with MRTPC Regulations, 1991.

The Central Government has framed the Monopolies and Restrictive Trade Practices Rules, 1970, the Monopolies and Restrictive Trade Practices (Classification of Goods) Rules, 1971, and the M.R.T.P. (Information) Rules, 1971 in exercise of the powers conferred under the Act. However these Rules have lost much of their significance in view of deletion of Sections 21 to 26 of the Act w.e.f. 27.9.91.

### **MRTP (Amendment) Act, 1991**

The new industrial policy announced by the Government in Parliament on July 24, 1991 sought to amend the MRTP Act, 1969 by removing all pre-entry restrictions and placing more emphasis on controlling and regulating monopolistic, restrictive and unfair trade practices.

The 'Statement of Objects and Reasons to the MRTP (Amendment) Act, 1991 reiterates that the basic philosophy behind the MRTP Act, 1969 was not to inhibit industrial growth but to ensure that industrial growth was channelised for public good and growth did not perpetuate concentration of economic power to the common detriment. To quote,

1. With the growing complexity of industrial structure and the need for achieving economies of scale for ensuring higher productivity and competitive advantage in the international market, the thrust of the industrial policy has shifted to controlling and regulating the monopolistic, restrictive and unfair trade practices rather than making it necessary for certain undertakings to obtain prior approval of the Central Government for expansion, establishment of new undertakings, merger, amalgamation, take over and appointment of directors. It has been the experience of the Government that pre-entry restrictions under the MRTP Act on the investment decision of the corporate sector has outlived its utility and has become a hindrance to the speedy implementation of industrial projects. By eliminating the requirement of time-consuming procedures and prior approval of the Government, it would be possible for all productive sections of the society to participate in efforts for maximisation of production. It is, therefore, proposed to re-structure the MRTP Act by omitting the provisions of Sections 20 to 26 and transfer the provisions contained in Chapter III-A regarding restrictions on acquisition and transfer of shares to the Companies Act, 1956. The Schedule to the MRTP Act is also consequently to be transferred with modification to the Companies Act, 1956.
2. It is also proposed to enlarge the scope of inquiry by the MRTP Commission with a view to taking effective steps to curb and regulate monopolistic, restrictive and unfair trade practices which are prejudicial to public interest. It is also proposed to provide for deterrent punishment for contravention of the orders passed by the MRTP Commission and the Central Government and empower the Commission to punish for its contempt. Certain other consequential changes are also found necessary in the MRTP Act.

### **Scope and Applicability of the MRTP Act**

Section 3 of the MRTP Act, 1969 provides that unless the Central Government, by notification in the Official Gazette otherwise directs, the Act shall not apply to:

- (a) undertakings owned or controlled by the Government, a government company, a corporation, a registered cooperative society and undertakings, the management of which has been taken over by the Central Government;
- (b) trade unions and other associations of workmen;
- (c) financial institutions.

However, vide notification dated 27.9.1991, the Government has directed that the provisions of the MRTP Act shall apply to all undertakings and financial institutions specified in Section 3 which were hitherto outside the purview of the Act, except undertakings owned or controlled by a Government company, or the Government and engaged in the production of arms and ammunition and allied items of defence equipment, defence aircraft and warships, atomic energy, minerals specified in the schedule to the Atomic Energy (Control of Production and Use) Order, 1953 and industrial units under the Currency and Coinage Division, Ministry of Finance, Department of Economic Affairs. Thus, the hitherto anomaly which used to exist prior to 27.9.91 about applicability of provisions of Act between private sector enterprises and public sector undertakings and those stated in sub-clause (a) to (g) of Section 3, has been removed.

But trade unions and other associations of workmen or employees formed for their own reasonable protection as such workmen or employees continue to be exempt from the applicability of the MRTP Act. However, Truck owners

or operators Unions/Associations being not of workmen have been held to be subject to the jurisdiction of MRTP Commission by Supreme Court in the case of Bharatpur Truck Operators Union.

In effect, all public sector companies, except those engaged in the production of arms and ammunition etc. and industries under the Currency and Coinage Division, have been brought within the scope of the MRTP Act in respect of monopolistic, restrictive and unfair trade practices.

### Monopolistic Trade Practices

Prohibition of monopolistic trade practices is one of the objects of the MRTP Act, 1969. The word 'monopoly' has not been defined in the MRTP Act. But it is common knowledge that a pure monopoly as well as 'monopolistic' position leads to distortion of competition in the market, besides endangering in the normal circumstances concerted action to fix prices, supplies of commodities, etc. The result of such action is no doubt detrimental to the consuming public.

*The Monopolies Inquiry Commission made copious analysis of this aspect in its report. It is worth quoting the following passages from Chapter V of the report:*

Our study of product-wise concentration brings out prominently the fact that in a large number of industries, a single undertaking is the only supplier or at least has to its credit a very large portion of the market as compared with its competitors. Such an undertaking has the power to dictate the price of the commodity or services it supplies and to regulate its volume of production in such a manner as to maximize its profits. This power is what is generally understood by the words "monopoly power" Though in the strict etymological sense of the word, and in strict economic theory, monopoly exists when there is only one single supplier, there is no reason why an enterprise enjoying the power to dictate the price and thus to control the market even though it is not the single supplier should not be considered a monopoly. What happens in such cases is that the price decided upon by the dominant producer (or distributor) is followed by others who are in a position to compete. This price leadership phenomenon is in essence a manifestation of the price leaders power to dictate the price in the market. We think it proper therefore to include within the word monopoly not only the single supplier in a market but also the one dominant supplier who has the power to dictate the price in the market."

"The question that next arises is : When such a power is shared by a few enterprises being the dominant sellers, should they be considered to be holding a monopolistic position? We see no reason to exclude such dominant sellers from our understanding of monopoly. For, the essence of monopoly is the ability to dictate the price and control the market without being materially influenced by other competing concerns."

One important difference between the situation when a single seller dominates the market and a few independent sellers together enjoy a dominating position cannot be overlooked. In the former case, monopoly power is inevitably present, in the latter it may or not be present. The effect on the market of a few dominant sellers has been widely discussed by economists, specially in recent years; but their opinions are by no means the same. We do not propose to try to resolve this controversy. It is sufficient for our purpose to notice that it is generally agreed that when a few big sellers dominate the market there will ordinarily be a high probability of their coming to some kind of agreement or understanding whether formal or not, about the price and output, by which a monopolistic power is shared between themselves. Even in the absence of such agreement or understanding it frequently happens that each has a healthy fear of the other big producers or distributors and ultimately a policy of live and let live comes into operation. Some economists point out that when a few large sellers dominate the market, each of them is able to calculate fairly and accurately the probable effect on the market of his action in increasing or decreasing his output. So, it is said that each will try to regulate the output in such a way that the marginal costs remain well below the price. Each such seller will also be well aware that any attempt of his to reduce the price is likely to be met immediately by similar action by his competitors. The matter is succinctly put by Stocking in Monopoly and Free Enterprise at p. 90 thus:

"In markets where sellers are few, each in trying to determine his most profitable volume of output must, as would a monopolist, consider the probable effects of various possible rates of production not only on costs but also on prices. Indeed each seller will ordinarily decide on the price at which he will sell and adjust his output accordingly, just as a monopolist does. Each oligopolist however in determining his price must consider not merely his own cost-price relationships but also how his rivals will react to his prices. Anyone of a few sellers, if fully informed and

perfectly rational, when selling a completely standardised product will realise that if he reduces his prices his rivals will meet the lower price promptly.

For all these reasons, we are convinced that when the market is dominated by a few sellers, monopolistic conditions will sometimes prevail. At the same time, we are conscious that even in a market of a few sellers, there will sometimes be keen competition. This is likely to happen apart from the effect of the mutual jealousies which sometimes characterise the relations between big business houses when one or more of the few sellers feel confident that due to superior managerial ability and technical skill and financial resources they will be able to capture a larger share of the market at the expense of their rivals. Even so, there is no gainsaying the fact that in a market of a few dominating sellers, there is real risk of the emergence of monopolistic power and consequently of monopolistic practices. To ascertain the extent to which monopolistic practices prevail, we must examine not only the cases where a single enterprise is the sole or dominant producer of the goods or services but also the cases where a few enterprises between themselves share such dominating position."

### **Restrictive Trade Practices**

The Monopolies and Restrictive Trade Practices Act, 1969, has as one of its objects the prohibition of restrictive trade practices. In order to ensure that the benefits of free and fair competition in a market reach the ultimate consumer, it is essential that the process of competition should not be distorted by any trade practice, either by a single manufacturer or a group of manufacturers or dealers. For instance, if a manufacturer stipulates a condition that the wholesale purchaser shall sell only his products and not of others or shall resell the goods only at the prices stipulated by him or forces the wholesale purchaser to procure the entire line of manufacture from him, the result may be a distortion of competition in the market. The MRTP Act is concerned with promoting fair and free competition in the market, the securing of consumer interest being the ultimate goal.

The Monopolies Inquiry Commission in its report observed that a restrictive trade practice means a practice which obstructs the free play of competitive forces or impedes the free flow of capital or resources into the stream of production or of the finished goods in the stream of distribution at any point before they reach the hands of the ultimate consumer. The Commission list out the following types of restrictive trade practices pursued not only in India but also in many other countries. These include (i) horizontal fixation of price; (ii) vertical fixation of price and re-sale price maintenance; (iii) allocation of markets between purchasers; (iv) discrimination between purchasers; (v) boycott; (vi) exclusive dealing contracts; and (vii) tie-up arrangements.

The Monopolies Inquiry Commission made a wee-bit of distinction between a monopolistic trade practice and a restrictive trade practice. It observed every monopolistic trade practice is on the face of it a restrictive trade practice. Indeed, sometimes the two words are used indiscriminately. Thus the report of Macquarie Committee which was set up to study Canadian Combines Legislation treats all combines or common policy among several firms designed to strengthen the market position of a group of firms as monopolistic practices. In our opinion, every practice whether it is by action or understanding or agreement, formal or informal, to which persons enjoying monopoly power resort in exercise of the same to reap the benefits of that power and every action, understanding or agreement tended to or calculated to preserve, increase or consolidate such power should properly be designated as monopolistic trade practice.

### **Unfair Trade Practices**

Unfair trade practices in trade and commerce were prevalent even in older days. Priests in Sumaria and Babylon are on record to have lent money to the needy at high rates of interest. During the period of Tudors, practices of forestalling (meaning pushing up prices by buying up supplies before they reached market), regrating (buying up supplies in the market), and engrossing (buying up supplies wherever available) were prevalent. Thus exploitation at market place is not a new phenomena of modern civilisation. At present various types of unfair trade practices are prevalent at National as well as at International markets. The legislative history of countries the world over bears redeeming testimony to the endeavours of the National Governments to enact suitable legislations to curb such unfair trade practices.

The underlying objective of such legislative endeavours has been to make the behaviour at market place conducive to righteous dealings so that the ultimate consumer gets a fair deal. Senator Murphy, the then Australian Attorney General, introducing the Restrictive Trade Practices Bill of the Commonwealth of Australia in the Senate said: In

consumer transactions, unfair practices are widespread. The existing law is still founded on the principle known as 'Caveat Emptor meaning 'let the buyer beware. That principle may have been appropriate for transactions conducted in village markets, it has ceased to be appropriate as a general rule. Now the marketing of goods and services is conducted on organised basis and by the trained business executives. The untrained consumer is no match for the businessman who attempts to persuade the consumer to buy goods or services on terms and conditions suitable to the vendor. The consumer needs protection by the law and this Bill will provide such protection.

It is often said that consumers need no special protection; all can be safely left to the market. But the concept of perfect market is an economists dream and consumers sovereignty a myth. In real life products are complex and of great variety and consumers and retailers have imperfect knowledge. Suppliers may often have a dominant buying position. As a consequence bargaining power in the market is generally weighed against the consumer. Thus consumers have felt the need to create organisations to identify their interests and to supply information and advice.

The Federal Trade Commission of US is stated to have labelled under the Federal Trade Commission Act, 1914 numerous practices not known before. It was because a need was felt to ensure that the public was prevented from being made victims of false claims of products blatantly advertised even though it may not have an adverse effect on the competition. The effort was to shift the emphasis on detection and eradication of fraud against the consumers, particularly those belonging to the weaker sections of the society.

### **Consumer Protection Law in India**

The Government enacted various laws to safeguard the interest of the consumers. The Essential Commodities Act, The Trade Marks Act, The Specific Relief Act, The Drugs Control Act, The Drugs and Cosmetics Act, The Drugs and Magic Remedies (Objectionable Advertisements) Act, The Emblems and Names (Prevention of Improper Use) Act, The Indian Standard Institution (Certification Marks) Act, The Agricultural Produce (Grading and Marketing) Act, The Standards of Weights and Measures Act, etc. are a few of the many laws intended to protect the interest of the consumer. Some of these laws alongwith the delegated legislation framed thereunder protect both the pecuniary interest as well as other interests of the consumer. Even the Indian Contract Act 1872 and the Sale of Goods Act, 1930 contain provisions for breach of contracts and remedies therefor. The Indian Penal Code provides for stringent punishment for certain offences.

In the year 1986, the Government enacted the Consumer Protection Act, 1986 and framed necessary rules thereunder, for facilitating the formation of Consumer Protection Councils in all states and setting up of Consumer Forums at district level, State Commission at state level and National Commission at national level for redressing the grievances of consumers. The Government also framed the MRTP (Recognition of Consumer Association) Rules and amended a number of economic legislations like the Essential Commodities Act, 1955; Standards of Weights and Measures Act, 1976; Prevention of Food Adulteration Act, 1954; Drugs and Cosmetics Act, 1940 etc. to provide better protection to consumers.

However, the passing of the MRTP Act, 1969, could be said to be the beginning of the Governments concern for consumer interest. Till the amendment of the Act in the year 1984, even the MRTP Act did not contain provisions directly aimed at protecting the interests of consumer, but they were intended to regulate competition in the hope that it would generate fair conduct, the effect of which would percolate to the ultimate consumer, the terminal point in the distributive line.

### **Recommendations of Sachar Committee**

The Government of India appointed a Committee in August, 1977 under the Chairmanship of Justice Rajinder Sachar to look into the simplification of the working of the companies and the MRTP Act. The Committee submitted its report in the year 1978 and as far as recommendations pertaining to the MRTP Act are concerned, far reaching changes were suggested by the Committee. For the first time, the Committee highlighted the need for introduction of suitable provisions to curb unfair trade practices.

In its view, the assumption that curbing monopolistic and restrictive trade practices and thereby preventing distortion of competition automatically results in the consumers getting a fair deal was only partly true. It was felt necessary to protect the consumers from practices adopted by trade and industry to mislead or dupe them.

The Committee pointed out that advertisements and sales promotion having become well established modes of modern business techniques, representations through such advertisements to the consumer should not become deceptive. If a consumer was falsely induced to enter into buying goods which do not possess the quality and did not have the cure for the ailment advertised, it was apparent that the consumer was being made to pay for quality of things on false representation. Such a situation could not be accepted.

Therefore, an obligation is to be cast on the seller to speak the truth when he advertises and also to avoid half truths, the purpose being preventing false or misleading advertisements.

The Committee also noted that fictitious bargain was another common form of deception and many devices were used to lure buyers into believing that they were getting something for nothing or at a nominal value for their money. The Committee observed: Prices may be advertised as greatly reduced and cut when in reality the goods may be sold at sellers regular prices. Advertised statements that could have two meanings, one of which is false, are also considered misleading. In America, it was held that statement that a tooth paste fights decay could be interpreted as a promise of complete protection and was thus deceptive. Mock-ups on television put up by companies including Colgate Palmolive had also received the attention of the Enforcement Agencies in America and have been held to be deceptive.

We cannot say that the type of misleading and deceptive practices which are to be found in other countries are not being practised in our country. Unfortunately our Act is totally silent on this aspect. The result is that the consumer has no protection against false or deceptive advertisements. Any misrepresentation about the quality of a commodity or the potency of a drug or medicine can be projected without much risk. This has created a situation of a very safe heaven for the suppliers and a position of frustration and uncertainty for the consumers.

It should be the function of any consumers legislation to meet this challenge specifically. Consumer protection must have a positive and active role.

Accordingly, the Committee specified certain unfair trade practices which were notorious and suggested prohibition of such practices. The main category of unfair trade practices recommended for prohibition by the Sachar Committee were: (a) misleading advertisements and false representations (b) bargain sale, bait and switch selling; (c) offering gifts or prizes with the intention of not providing them and conducting promotional contests; (d) supplying goods not conforming to safety standards; and (e) hoarding and destruction of goods.

In India, by an amendment to the MRTP Act in the year 1984 Part B Unfair Trade Practices was added to Chapter V. It may be recalled that Part A of Chapter V deals with registration of agreements relating to restrictive trade practices. Section 36A, 36B, 36C, 36D and 36E are relevant for the purposes of understanding the main provisions relating to unfair trade practices.

### Recommendations of Raghavan Committee

As India moved steadily on the path of reforms comprising of Liberalisation, Privatisation and Globalisation, it did away with the MRTP Act, 1969 as it was realised that the Act had outlived its utility and control of monopoly was not appropriate to support the growth aspirations of more than 1 billion Indians. Indeed, need was felt to promote and sustain competition in the market place. The then Finance Minister (Shri.Yashwant Sinha) in the budget speech in 1999 had announced:

*"The Monopolies and Restrictive Trade Practices Act has become obsolete in certain areas in the light of international economic developments relating to competition laws. We need to shift our focus from curbing monopolies to promoting competition. Government has decided to appoint a Committee to examine this range of issues and propose a modern Competition Law suitable for our conditions."*

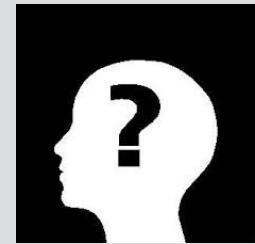
Accordingly, a High Level Committee on Competition Policy and Law was constituted under Chairmanship of Mr. S.V.S Raghavan. The Committee submitted its report on 22nd May 2000 recommending replacement of the MRTP Act with a modern competition law for fostering competition and for eliminating anticompetitive practices in the economy. After consulting the stakeholders, Competition Bill, 2001 was introduced in the Parliament which eventually became the Competition Act, 2002.

The purpose of the Competition Act, as stated in its preamble is: *"An Act to provide, keeping in view of the economic development of the country, for the establishment of a Commission to prevent practices having adverse effect on*

*competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets, in India, and for matters connected therewith or incidental thereto."*

### **Why do we need competition in the market?**

Competition is now universally acknowledged as the best means of ensuring that consumers have access to the broadest range of services at the most competitive prices. Producers will have maximum incentive to innovate, reduce their costs and meet consumer demand. Competition thus promotes allocative and productive efficiency. But all this requires healthy market conditions and governments across the globe are increasingly trying to remove market imperfections through appropriate regulations to promote competition.



## **COMPETITION ACT, 2002**

### **Short title, extent and commencement**

Section 1 of the Act provides that it shall come into force on such date as the Central Government may notify in the Official Gazette. However, an enabling provision empowering the Government to appoint different dates for different provisions of the Act have been incorporated.

### **Scheme of the Act**

The Scheme of the Act has been split into nine chapters indicated hereunder: Chapter I contains preliminary provisions viz. Short title, extent and Definition clauses; Chapter II provides for substantive laws i.e. Anti Competitive Agreements, Abuse of Dominance and Regulation of Combinations; Chapter III contains provisions relating to Establishment of Commission, Composition of Commission, Selection of Committee for Chairperson and other Members, Term of Office of Chairperson etc. Chapter IV elaborately provides the Duties, Powers and Functions of the Commission; Chapter V provides for the Duties of Director General; Chapter VI stipulates Penalties for Contravention of Orders of Commission, Failure to Comply with Directions of Commission and Director-General, Making False Statement or Omission to Furnish Material Information etc; Chapter VII deals with Competition Advocacy; Chapter VIII contains provisions relating to Finance, Accounts and Audit, Chapter VIII A contains provisions relating to "Appellate Tribunal" and Chapter IX contains Miscellaneous provisions.

In the case of *Competition Commission of India Vs Steel Authority of India Ltd. & Anr in Civil Appeal No. of 2010 judgement dated September 9, 2010* Hon'ble Supreme Court observed that the decision of the Government of India to liberalize its economy with the intention of removing controls persuaded the Indian Parliament to enact laws providing for checks and balances in the free economy. The laws were required to be enacted, primarily, for the objective of taking measures to avoid anti-competitive agreements and abuse of dominance as well as to regulate mergers and takeovers which result in distortion of the market. The earlier Monopolies and Restrictive Trade Practices Act, 1969 was not only found to be inadequate but also obsolete in certain respects, particularly, in the light of international economic developments relating to competition law. Most countries in the world have enacted competition laws to protect their free market economies- an economic system in which the allocation of resources is determined solely by supply and demand. The rationale of free market economy is that the competitive offers of different suppliers allow the buyers to make the best purchase. The motivation of each participant in a free market economy is to maximize self-interest but the result is favourable to society. As Adam Smith observed: "there is an invisible hand at work to take care of this". As far as American law is concerned, it is said that the Sherman Act, 1890, is the first codification of recognized common law principles of competition law. With the progress of time, even there the competition law has attained new dimensions with the enactment of subsequent laws, like the Clayton Act, 1914, the Federal Trade Commission Act, 1914 and the Robinson-Patman Act, 1936. The United Kingdom, on the other hand, introduced the considerably less stringent Restrictive Practices Act, 1956, but later on more elaborate legislations like the Competition Act, 1998 and the Enterprise Act, 2002 were introduced. Australia introduced its current Trade Practices Act in 1974. The overall intention of competition law policy has not changed markedly over the past century. Its intent is to limit the role of market power that might result from substantial concentration in a particular industry. The major concern with monopoly and similar kinds of concentration is not

that being big is necessarily undesirable. However, because of the control exerted by a monopoly over price, there are economic efficiency losses to society and product quality and diversity may also be affected. Thus, there is a need to protect competition. The primary purpose of competition law is to remedy some of those situations where the activities of one firm or two lead to the breakdown of the free market system, or, to prevent such a breakdown by laying down rules by which rival businesses can compete with each other. The model of perfect competition is the 'economic model' that usually comes to an economist's mind when thinking about the competitive markets. As far as the objectives of competition laws are concerned, they vary from country to country and even within a country they seem to change and evolve over the time. However, it will be useful to refer to some of the common objectives of competition law. The main objective of competition law is to promote economic efficiency using competition as one of the means of assisting the creation of market responsive to consumer preferences. The advantages of perfect competition are three-fold: allocative efficiency, which ensures the effective allocation of resources, productive efficiency, which ensures that costs of production are kept at a minimum and dynamic efficiency, which promotes innovative practices. These factors by and large have been accepted all over the world as the guiding principles for effective implementation of competition law.

Further, in *Excel Crop Care India v Competition Commission of India ( Civil Appeal No. 2480 of 2014 judgement dated May 08, 2017, (2017) 8 SCC 47)* the Supreme Court Observed that in the instant case, we are concerned with the first type of practices, namely, anti-competitive agreements. The Act, which prohibits anti-competitive agreements, has a laudable purpose behind it. It is to ensure that there is a healthy competition in the market, as it brings about various benefits for the public at large as well as economy of the nation. In fact, the ultimate goal of competition policy (or for that matter, even the consumer policies) is to enhance consumer well-being. These policies are directed at ensuring that markets function effectively. Competition policy towards the supply side of the market aims to ensure that consumers have adequate and affordable choices. Another purpose in curbing anti-competitive agreements is to ensure level playing field for all market players that helps markets to be competitive. It sets rules of the game that protect the competition process itself, rather than competitors in the market. In this way, the pursuit of fair and effective competition can contribute to improvements in economic efficiency, economic growth and development of consumer welfare. It is well settled that the Competition Act, 2002 is a regulatory legislation enacted to maintain free market so that the Adam Smith's concept of invincible hands operate unhindered in the background. Further it is clear from the Statement of objects and reason that this law was foreseen as a tool against concentration of unjust monopolistic powers at the hands of private individuals which might be detrimental for freedom of trade. Competition law in India aims to achieve highest sustainable levels of economic growth, entrepreneurship, employment, higher standards of living for citizens, protect economic rights for just, equitable, inclusive and sustainable economic and social development, promote economic democracy, and support good governance by restricting rent seeking practices. Therefore an interpretation should be provided which is in consonance with the aforesaid objectives.

## DEFINITIONS

The term "Competition" is not defined in the Act. However, in the corporate world, the term is generally understood as a process whereby the economic enterprises compete with each other to secure customers for their product. In the process, the enterprises compete to outsmart their competitors, sometimes to eliminate their rivals. Competition in the sense of economic rivalry is unstable and has a natural tendency to give way to a monopoly. Thus, competition kills competition.

The important concepts incorporated in the Competition Act, 2002 have been defined under Section 2 of the Act. These have been discussed herein below:

### Acquisition

This term has been specifically defined. It means – directly or indirectly, acquiring or agreeing to acquire: (i) shares, voting rights or assets of any enterprise; (ii) control over management or control over assets of any enterprise. [(Section 2(a))]

The terms 'acquiring' or 'acquisition' are relevant for "Regulation of Combinations".

## Agreement

The term includes any arrangement or understanding or action in concert –

- (i) whether or not, such arrangement, understanding or concert is in formal or in writing; or
- (ii) whether or not such arrangement, understanding or concert is intended to be enforceable by legal proceedings.

It implies that an arrangement need not necessarily be in writing. The term is relevant in the context of Section 3, which envisages that anti-competitive agreements shall be void and thereby prohibited by the law. [Section 2(b)]

The term “Competition” is not defined in the Act. However, in the corporate world, the term is generally understood as a process whereby the economic enterprises compete with each other to secure customers for their product. In the process, the enterprises compete to outsmart their competitors, sometimes to eliminate their rivals. Competition in the sense of economic rivalry is unstable and has a natural tendency to give way to a monopoly. Thus, competition kills competition.

## Cartel

“Cartel” includes an association of producers, sellers or distributors, traders or service providers who, by agreement amongst themselves, limit control or attempt to control the production, distribution, sale or price of or, trade in goods or provision of services. [Section 2(c)]

The nature of a cartel is to raise price above competitive levels, resulting in injury to consumers and to the economy. For the consumers, cartelisation results in higher prices, poor quality and less or no choice for goods or/and services.

An international cartel is said to exist, when not all of the enterprises in a cartel are based in the same country or when the cartel affects markets of more than one country.

An import cartel comprises enterprises (including an association of enterprises) that get together for the purpose of imports into the country.

An export cartel is made up of enterprises based in one country with an agreement to cartelize markets in other countries. In the Competition Act, cartels meant exclusively for exports have been excluded from the provisions relating to anti-competitive agreements. This is because such cartels do not adversely affect markets in India and are hence outside the purview of the Competition Act.

If there is effective competition in the market, cartels would find it difficult to be formed and sustained.

### ***Some of the conditions that are conducive to cartelization are:***

- high concentration - few competitors
- high entry and exit barriers
- homogeneity of the products (similar products)
- similar production costs
- excess capacity
- high dependence of the consumers on the product
- history of collusion

## Chairperson

Chairperson means the Chairperson of Competition Commission of India appointed under Sub-section (1) of Section 8. [Section 2(d)]

## Commission

Commission means Competition Commission of India established under Section 7(1). [Section 2(e)]

## Consumer

Under that Act, the Consumer includes only such purchasers or buyers who make purchases for their own consumption or to earn their livelihood. This deficiency has now been made good – by defining “Consumer” under the Act. Consumer means any person who –

- (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or under any system of deferred payment when such use is made with the approval of such person, whether such purchase of goods is for resale or for any commercial purpose or for personal use.
- (ii) hires or avails of any services for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment when such services are availed of with the approval of the first mentioned person whether such hiring or availing of services is for any commercial purpose or for personal use. [Section 2(f)]

It may be noted that under the Competition Act even if a person purchases goods or avails of services for commercial purpose, he will be a Consumer, whereas for purposes of Consumer Protection Act, a person purchasing goods/ availing services for commercial purposes is not a “Consumer” and can not seek relief under that Act.

## Director General

Director General means the Director General appointed under Section 16(1) and includes Additional, Joint or Deputy or Assistant Director Generals. [Section 2(g)]

## Enterprise

Enterprise means a person or a department of the Government, who or which is, engaged in any activity, relating to production, control of goods or articles or provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or dealing with shares, debentures or other securities whether such unit or division or subsidiary is located at the same place where the enterprise is located or at different place(s).

However, it does not include any activity of the Central Government relating to sovereign functions of Government including all activities carried on by the Government Departments dealing with atomic energy, currency, defence and space.

‘Activity’ includes profession or occupation. ‘A unit or division’ includes a plant or factory established for production, supply, distribution, acquisition or control of any goods or any branch or office established for provision of any service. [Section 2(h)]

It may thus be noted that sovereign function of Government are excluded from definition of enterprise but Government Departments performing non-sovereign functions for consideration are subject to jurisdiction of Commission.

## Goods

Goods means goods as defined in Sale of Goods Act, 1930 and –

- (a) products manufactured, processed or mined;
- (b) debentures, shares and stocks after allotment;
- (c) in relation to ‘goods supplied’, goods imported into India. [Section 2(i)]

## Member

Member means a Member of the Commission appointed under Section 8(1) of the Act and includes a Chairperson. [Section 2(j)]

## Notification

Notification means notification published in the Official Gazette. [Section 2(k)]

## Person

Person includes (i) an individual; (ii) a Hindu undivided family; (iii) a company; (iv) a firm; (v) an association of persons; (vi) a corporation established under Central, State Act or a Government Company (vii) a body corporate incorporated by or under a law of a foreign country; (viii) a co-operative society registered under any Law (ix) local authority (x) every artificial juridical person.

'Government Company' for this Section will be same as defined under Section 617 of Companies Act, 1956. [Section 2(p)]

## Practice

Practice includes any practice relating to carrying on of any trade by a person or enterprise. [Section 2(p)]

## Prescribed

Prescribed means prescribed by rules made under the Act by Central Government. [Section 2(n)]

## Price

Price, in relation to sale of goods or supply of services, includes every valuable consideration, whether direct or indirect, or deferred, and includes any consideration, which relates to sale of any goods or to performance of any services although ostensibly relating to any other matter or thing. [Section 2(o)]

## Public Financial Institution

Public Financial Institution means a Public Financial Institution as defined in Section 4A of Companies Act, 1956 and includes a State Financial, Industrial or Investment corporation. [Section 2(p)]

## Regulations

Regulations means the regulations made by the Competition Commission of India. [Section 2(q)]

## Relevant Market

Relevant market means the market, which may be determined by the Commission with reference to 'relevant product market' or 'relevant geographic market' or with reference to both the markets. [Section 2(r)]

## Relevant Geographic Market

Relevant Geographic Market means a market comprising the area in which the conditions of competition for supply of goods or provision of services or demand of goods or services are distinctly homogenous and can be distinguished from conditions prevailing in neighbouring areas. [Section 2(s)]

## Relevant Product Market

Relevant Product Market means a market comprising of all those products or services which are regarded as interchangeable or substitutable by the consumer, by reasons of characteristics of products or services, their prices and intended use. [Section 2(t)]

The terms 'relevant market', 'relevant geographical market' and 'relevant product market' have relevance in determination of the agreements being anti competitive, in evaluating combinations and dominance of an enterprise or group. An agreement in the nature of cartel which limits or controls production, supply, market, technical development, investments etc. need to be looked as being anti competitive with reference to relevant market. Similarly agreement to share the market or sources of production by way of allocation of geographical area of market, types of goods or services or number of customers in the market or by any similar way and these need to be interpreted in the context of the definition of relevant geographical market under Section 2(s).

## Service

Service means service of any description which is made available to potential users and includes the provision of services in connection with business of any industrial or commercial matters such as banking, communication,

education, financing, insurance, chit funds, real estate, transport, storage, material treatment, processing, supply of electrical or other energy, boarding, lodging, entertainment, amusement, construction, repair, conveying of news or information and advertising. [Section 2(u)]

It may be noted that under the Competition Act, the services of industrial or commercial nature also fall within the scope of the Act whereas under the Consumer Protection Act, the services of commercial nature or for business or industrial purposes are excluded for interpreting deficiency in the supply thereof and for determining compensation, if any, payable to them. To this extent, the relief claimable under the Consumer Protection

Act, 1986 is limited in scope. It may also be noted that "education" has been specifically included in ambit of "Service" to set at rest the dispute, if any, about the jurisdiction of Commission in such matters.

### **Shares**

Shares means shares in the share capital of a company carrying voting rights and includes, –

- (i) any security which entitles the holder to receive shares with voting rights;
- (ii) stock except where a distinction between stock and share is expressed or implied. [Section 2(v)]

This definition of shares is much wider than what is provided under the Companies Act. It implies that not only shares in the share capital of a company e.g. equity or preference shares are included in the definition of shares but 'debentures convertible into shares with voting rights' are also included.

### **Statutory Authority**

Statutory authority means any authority, board, corporation, council, institute, university or any other body corporate, established by or under any Central, State or Provincial Act for the purposes of regulating production or supply of goods or provision of any services or markets therefor or any matter connected therewith or incidental thereto. [Section 2(w)]

It implies that this definition widens the scope of type of bodies, which are empowered to make a reference for enquiring into anti-competitive agreement or abuse of dominant position or make a reference for opinion on a competition issue.

### **Trade**

Trade means any 'trade' business, industry, profession or occupation relating to production, supplies, distribution, storage or control of goods and includes the provision of any services.

The definition of the term 'trade' is relevant, inter-alia, to the interpretation of any of the type of agreement listed in Section 4 (a), (b), (c), (d) and (e) in relation to the trading goods and provisions of services. [Section 2(x)]

### **Turnover**

Turnover includes value of sale of goods or services. [Section 2(y)]

The definition of the term 'turnover', inter-alia, is relevant and significant in determining whether the combination of merging entities exceeds the threshold limit of the turnover specified in Section 5 of the Act. It is also relevant for the purpose of imposition of fines by the Commission.

Section 2 further provides that the words and expression used but not defined in the Competition Act, 2002 and defined in the Companies Act, 1956 [(1) of 1956] shall have the same meaning respectively assigned to them in the Companies Act, 1956 (1 of 1956).

Chapter II of the Competition Act, 2002 stipulates provisions relating to Prohibition of Certain Agreements, Abuse of Dominant Position and Regulations of Combinations.

### **Anti Competitive Agreements**

It is provided under Section 3(1) of the Competition Act that no enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage,

acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition. Section 3(2) further declares that any anti competitive agreement within the meaning of sub-section 3(1) shall be void. Under the law, the whole agreement is construed as 'void' if it contains anti- competitive clauses having appreciable adverse effect on competition. Section 3(3) provides that following kinds of agreements entered into between enterprises or association of enterprises or persons or associations of persons or person or enterprise or practice carried on, or decision taken by any association of enterprises or association of persons, including "cartels", engaged in identical or similar goods or services which –

- (a) directly or indirectly determines purchase or sale prices;
- (b) limits or controls production, supply, markets, technical development, investment or provision of services;
- (c) shares the market or source of production or provision of services by way of allocation of geographical area of market, or type of goods or services, or number of customers in the market or any other similar way; and
- (d) directly or indirectly results in bid rigging or collusive bidding;

shall be presumed to have an appreciable adverse effect on the competition and onus to prove otherwise lies on the defendant.

Such agreements are known as horizontal agreements because they are entered into between enterprises engaged in identical or similar goods or services. The above stated four categories include agreements, practice or decision by enterprises for- price fixation, output control, market allocation and bid rigging.

The explanation appended to the Section 3 defines the term 'bid rigging' as any agreement between enterprises or persons which has the effect of eliminating or reducing competition for bids or adversely affecting or manipulating the process for bidding. Efficiency enhancing joint ventures entered into by parties engaged in identical or similar goods or services, shall not be presumed to have appreciable adverse effect on competition but judged by rule of reason. The term "cartel" used in the Section is the most severe form of entering into 'anti competitive agreements' and has been defined in Section 2(c).

Bid rigging takes place when bidders collude and keep the bid amount at a pre-determined level. Such pre-determination is by way of intentional manipulation by the members of the bidding group. Bidders could be actual or potential ones, but they collude and act in concert.

### **Bid rigging is anti-competitive**

Bidding, as a practice, is intended to enable the procurement of goods or services on the most favourable terms and conditions. Invitation of bids is resorted to both by Government (and Government entities) and private bodies (companies, corporations, etc.). But the objective of securing the most favourable prices and conditions may be negated if the prospective bidders collude or act in concert. Such collusive bidding or bid rigging contravenes the very purpose of inviting tenders and is inherently anti-competitive.

#### ***Some of the most commonly adopted ways in which collusive bidding or bid rigging may occur are:***

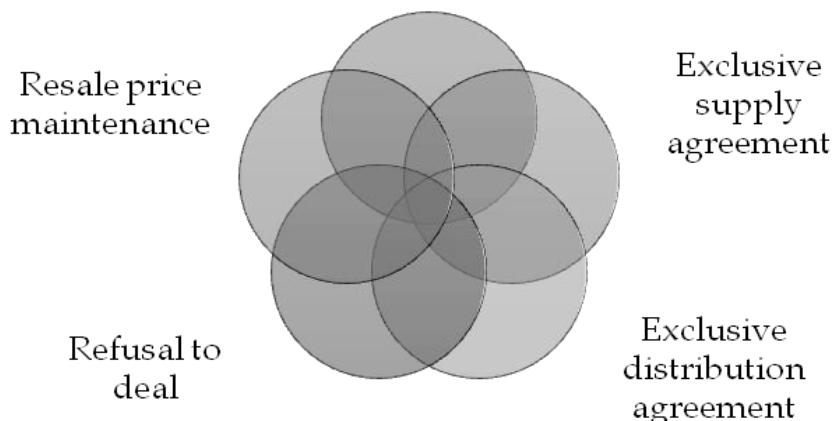
- agreements to submit identical bids
- agreements as to who shall submit the lowest bid, agreements for the submission of cover bids (voluntarily inflated bids)
- agreements not to bid against each other,
- agreements on common norms to calculate prices or terms of bids
- agreements to squeeze out outside bidders
- agreements designating bid winners in advance on a rotational basis, or on a geographical or customer allocation basis



If bid rigging takes place in Government tenders, it is likely to have severe adverse effects on its purchases and on public spending. Bid rigging or collusive bidding is treated with severity in the law. The presumptive approach reflects the severe treatment.

Section 3(4) provides that any agreement amongst enterprises or persons at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or price of, or trade in goods or provision of services, including -

### Tie-in agreement



shall be an agreement in contravention of sub-section (1) if such agreement causes or is likely to cause an appreciable adverse effect on competition in India.

Such agreements are known as vertical agreements as they are entered into enterprises at different stages in the production or supply chain. Rule of reason is applicable to such agreements in order to find appreciable adverse effect on competition. Agreements that are likely to cause appreciable adverse effect on competition also fall under sub-section (4).

The term "**tie-in agreement**" includes any agreement requiring a purchaser of goods, as a condition of such purchase, to purchase some other goods. A good example of tie-in agreement is where a gas distributor requires a consumer to buy a gas stove as a pre condition to obtain connection of domestic cooking gas. [*Chanakaya and Siddharth Gas company, In-re RTP 11/1985* decided by (MRTP Commission on 27.1.1985)]

"**Exclusive supply agreement**" includes any agreement restricting in any manner from acquiring or otherwise dealing in any goods other than those of the seller or any other person. Thus, where a manufacturer asks a dealer not to deal in similar products of its competitor directly or indirectly and discontinues the supply on the ground that dealer also deals in product of suppliers' competitor's goods is an illustration of exclusive dealing agreement. [*Bhartia Curtec Hammer Ltd. In-re* (1997) 24 CLA 104 (MRTPC)]

"**Exclusive distribution agreement**" includes any agreement to limit, restrict or withhold the output or supply of any goods or allocate any area or market for the disposal or sale of the goods.

Requiring a distributor not to sell the goods of the manufacturer beyond the prescribed territory is a good example of exclusive distribution agreement. *Vadilal Enterprise Ltd. In-re* (1998 (91) COMP CAS 824 is a good example of exclusive distribution agreement.

"**Refusal to deal**" includes any agreement, which restricts, or is likely to restrict, by any method the persons or classes of persons to whom goods are sold or from whom goods are bought. For eg. an agreement which provides that the franchisees will not deal in products or goods of similar nature for a period of three years from the date of determination of agreement within a radius of five kms from showroom amounts to exclusive dealing agreement. *DGIR v. Titan industries* (2001) 43 CLA 293 MRTPC.

"**Resale price maintenance**" includes any agreement to sell goods on condition that the prices to be charged on resale by the purchaser shall be the prices stipulated by the seller unless it is clearly stated that prices lower than those prices may be charged.

Any stipulation that the cement dealer should not sell below the stipulated price is a 'resale price maintenance' practice and is an anti competitive practice. (In re-India Cement Ltd. RTP Inquiry 48 /1985).

The agreements falling in Section 3(3) shall be presumed to have appreciable adverse effect on competition and thereby they are construed as deemed restrictive agreements. The agreements falling in Section 3(4) shall be judged by rule of reason and the onus lies on the prosecutor to prove its appreciable adverse effect on competition. The definition of all restrictive concepts covered under Section 3(4) is inclusive one.

Moreover, Section 3 does not restrict the right of any person to restrain any infringement of or to impose reasonable conditions, as may be necessary for protecting any of his rights which have been or may be conferred upon him under-

- (a) the Copyright Act, 1957;
- (b) the Patents Act, 1970;
- (c) the Trade and Merchandise Marks Act, 1958 or the Trade Marks Act, 1999;
- (d) the Geographical Indications of Goods (Registration and Protection) Act, 1999;
- (e) the Designs Act, 2000;
- (f) the Semi-conductor Integrated Circuits Layout-Design Act, 2000.

That apart, the Act does not restrict any person's right to export from India goods under an agreement which requires him to exclusively supply, distribute or control goods or provision of services for fulfilling export contracts. The exclusion of 'export business' is in view of 'effect theory', and doctrine of 'relevant market'.

#### **WHAT IS AN ANTI-COMPETITIVE AGREEMENT?**

An anti-competitive agreement is an agreement having appreciable adverse effect on competition. Anti-competitive agreements include, but are not limited to:-

- agreement to limit production and/or supply;
- agreement to allocate markets;
- agreement to fix price;
- bid rigging or collusive bidding;
- conditional purchase/ sale (tie-in arrangement);
- exclusive supply / distribution arrangement;
- resale price maintenance; and
- refusal to deal.



#### **Prohibition of Abuse of Dominant Position**

Section 4 of the Competition Act, 2002 expressly prohibits any enterprise or group from abusing its dominant position, meaning thereby a position of strength, enjoyed by an enterprise or group, in the relevant market, in India, which enables it to-

- (i) operate independently of competitive forces prevailing in the relevant market; or
- (ii) affect its competitors or consumers or the relevant market in its favour".

In line with the latest global trend, the dominance shall not be determined with reference to "assets", "turnover" or "market share".

As per Section 2(r) 'relevant market' means the market, which may be determined by the Commission with reference to the relevant 'product market' or 'relevant geographic market' or with reference to both the markets. Thus, for determining dominance, these are relevant concepts.

The term "enterprise" means a person or a department of the Government, who or which is, or has been, engaged in any activity, relating to the production, storage, supply, distribution, acquisition or control of articles or goods, or the provision of services, of any kind, or in investment, or in the business of acquiring, holding, underwriting or

dealing with shares, debentures or other securities of any other body corporate, either directly or through one or more of its units or divisions or subsidiaries, whether such unit or division or subsidiary is located at the same place where the enterprise is located or at a different place or at different places, but does not include any activity of the Government relatable to the sovereign functions of the Government including all activities carried on by the departments of the Central Government dealing with atomic energy, currency, defence and space.

For the purposes of this clause, "activity" includes profession or occupation; "article" includes a new article and "service" includes a new service; "unit" or "division", in relation to an enterprise, includes—

- (i) a plant or factory established for the production, storage, supply, distribution, acquisition or control of any article or goods;
- (ii) any branch or office established for the provision of any service.

Section 4(2) states that there shall be abuse of dominant position, if an enterprise or group –

- (i) directly or indirectly imposes unfair or discriminatory;
- (ii) condition in purchase or sale of goods or services; or
- (iii) price in purchase or sale (including predatory price) of goods or service.

Explanation appended to Section 4 (2) clarifies that the unfair or discriminatory condition in purchase or sale of goods or services shall not include any discriminatory condition or price which may be adopted to meet the competition.

Section 4(2)(b) includes in abuse of dominant position an enterprise or group limiting or restricting

- (i) production of goods or provision of services or market therefore; or
- (ii) technical or scientific development relating to goods or services to the prejudice of consumers.

Similarly Section 4 (2) (c), (d) and (e) specify three other forms of abuses namely, if any person indulges in practice or practices resulting in denial of market access in any manner; or makes conclusion of contracts subject to acceptance by other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts and also, if any person uses dominant position in one relevant market to enter into, or protect, other relevant market.

The term "predatory price" has been defined as the sale of goods or provision of services, at a price which is below the cost, as may be determined by regulations, of production of goods or provision of services, with a view to reduce competition or eliminate the competitors. Thus, the two conditions precedent to bring a case with the ambit of predatory pricing are:

- (i) selling goods or provision of service at a price which is below its cost of production and
- (ii) that practice is resorted to eliminate the competitors or to reduce competition.

The Competition Commission of India has been empowered under Section 19(4) of the Act to determine whether any enterprise or group enjoys a dominant position or not, in the 'relevant market' and also to decide whether or not there has been an abuse of dominant position. It may be noted that mere existence of dominance is not to be frowned upon unless the dominance is abused.

#### **WHAT CONSTITUTES ABUSE OF DOMINANCE?**

*Dominance refers to a position of strength which enables an enterprise to operate independently of competitive forces or to affect its competitors or consumers or the market in its favour. Abuse of dominant position impedes fair competition between firms, exploits consumers and makes it difficult for the other players to compete with the dominant undertaking on merit. Abuse of dominant position includes:*

- imposing unfair conditions or price,
- predatory pricing,
- limiting production/market or technical development ,
- creating barriers to entry,
- applying dissimilar conditions to similar transactions,
- denying market access, and
- using dominant position in one market to gain advantages in another market.



## Combinations

Combination has broad coverage and includes acquisition of control, shares, voting rights, assets, merger or amalgamation. Unless exempted, Commission's approval is mandatory under the Act, if jurisdictional thresholds in terms of assets or turnover either in India or in India and outside India, as the case may be (as set out in the table below), of the combining parties are met.

**Control:** As per explanation (a) to Section 5 of the Act "control" includes controlling the affairs or management by— (i) one or more enterprises, either jointly or singly, over another enterprise or group; (ii) one or more groups, either jointly or singly, over another group or enterprise. Accordingly, control defined under the Act refers to sole as well as joint control.

### WHAT IS COMBINATION?

Broadly, combination under the Act means acquisition of control, shares, voting rights or assets, acquisition of control by a person over an enterprise where such person has direct or indirect control over another enterprise engaged in competing businesses, and mergers and amalgamations between or amongst enterprises when the combining parties exceed the thresholds set in the Act. The thresholds are specified in the Act in terms of assets or turnover in India and outside India. Entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India is prohibited and such combination shall be void.



## THRESHOLDS FOR COMBINATION

On March 4, 2016, the Central Government issued notifications pertaining to the statutory thresholds for the purposes of "combinations" under Section 5 of the Competition Act, 2002 ("Act").

However, pursuant to Notification No. S.O. 675(E) dated March 4, 2016, the value of assets and the value of turnover has been enhanced by 100% for the purposes of Section 5 of the Act. Accordingly, the revised thresholds for notification to the Competition Commission of India ("CCI/ or Commission") are:

| THRESHOLDS FOR FILING NOTICE |                          |   |    |  |
|------------------------------|--------------------------|---|----|--|
|                              |                          | Assets  |    | Turnover   |
| Enterprise Level             | India                    | >2000 INR crore                                   | OR | >6000 INR crore                                    |
|                              | Worldwide with India Leg | >USD 1 bn with at least > 1000 INR crore in India |    | >USD 3 bn with at least > 3000 INR crore in India  |
| OR                           |                          |   |    |  |
| Group Level                  | India                    | >8000 INR crore                                   | OR | >24000 INR crore                                   |
|                              | Worldwide with India leg | >USD 4 bn with at least >1000 INR crore in India  |    | >USD 12 bn with at least > 3000 INR crore in India |

*De Minimis Exemption/ Target Exemption:* Pursuant to Notification No. S.O. 988(E) dated March 27, 2017, the Central Government, in public interest, has exempted the enterprises being parties to -- (a) any acquisition referred to in clause (a) of section 5 of the Competition Act; (b) acquiring of control by a person over an enterprise when such person has already direct or indirect control over another enterprise engaged in production, distribution or trading of a similar or identical or substitutable goods or provision of a similar or identical or substitutable service, referred to in clause (b) of section 5 of the Competition Act; and (c) any merger or amalgamation, referred to in clause (c) of section 5 of the Competition Act, where the value of assets being acquired, taken control of, merged or amalgamated is not more than rupees three hundred and fifty (350) crores in India or turnover of not more than rupees one thousand (1000) crores in India, from the provisions of section 5 of the said Act for a period of five years from the date of publication of this notification in the official gazette. Aforesaid Notification was published on March 29,

2017 in official gazette. De Minimis/Target Exemption was first notified by Central Government in 2011 and was initially applicable to acquisitions only. Thereafter, De Minimis/Target Exemption was revised in 2016 by the Central Government. De Minimis/Target Exemption was further revised vide aforesaid Notification dated March 27, 2017 by increasing the scope of Target Exemption to include acquisitions, mergers and amalgamations.

Aforesaid revised De Minimis/Target Exemption issued by the Central Government vide Notification dated March 27, 2017 also clarifies that where a portion of an enterprise or division or business is being acquired, taken control of, merged or amalgamated with another enterprise, the value of assets of the said portion or division or business and or attributable to it, shall be the relevant assets and turnover to be taken into account for the purpose of calculating the thresholds under section 5 of the Act. Revised De Minimis/Target Exemption further provides that the value of the said portion or division or business shall be determined by taking the book value of the assets as shown, in the audited books of accounts of the enterprise or as per statutory auditor's report where the financial statement have not yet become due to be filed, in the financial year immediately preceding the financial year in which the date of the proposed combination falls, as reduced by any depreciation, and the value of assets shall include the brand value, value of goodwill, or value of copyright, patent, permitted use, collective mark, registered proprietor, registered trade mark, registered user, homonymous geographical indication, geographical indications, design or layout design or similar other commercial rights, if any, referred to in sub-section (5) of section 3. The said revised De Minimis/Target Exemption also provides that the turnover of the said portion or division or business shall be as certified by the statutory auditor on the basis of the last available audited accounts of the company.

Accordingly, the revised threshold for availing of the De Minimis/Target exemption for acquisitions, mergers and amalgamations are:

| THRESHOLDS FOR AVALING OF DE MINIMISE EXEMPTION FOR ACQUISITIONS, MERGERS AND AMALGAMATIONS |          |                   |                 |
|---|----------|-------------------|-----------------|
|   |          | Assets            | Turnover        |
| Target Enterprise   | In India | ≤350 INR crore OR | ≤1000 INR crore |

### Regulation of Combinations

Section 6 of the Competition Act prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed, it shall be void. Combinations can be both horizontal and vertical. Horizontal combinations are considered to have more adverse effect on competition in relevant market due to consolidation. Section 6(2) envisages that any person or enterprise, who or which proposes to enter into any combination, shall give a notice to the Commission disclosing details of the proposed combination, in the form, prescribed and submit the form together with the fee prescribed by regulations. Such intimation should be submitted within 30 days of –

- (a) approval of the proposal relating to merger or amalgamation, referred to in Section 5(c), by the board of directors of the enterprise concerned with such merger or amalgamation, as the case may be;
- (b) execution of any agreement or other document for acquisition referred to in Section 5(a) or acquiring of control referred to in Section 5(b).

### EXEMPTION NOTIFICATIONS

**Exemption from filing notice to the Commission:** Pursuant to Notification No. S.O. 2039(E) dated June 29, 2017, Central Government, in public interest, has exempted every person or enterprise who is a party to a combination as referred to in section 5 of the Act from giving notice within thirty days mentioned in sub-section (2) of section 6 of the Act, subject to the provisions of sub-section (2A) of section 6 and section 43A of the said Act, for a period of five years from the date of publication of notification in Official Gazette. Accordingly, the benefit of aforesaid exemption will be available for 5 (five) years from June 29, 2017 till June 29, 2022. Above exemption does not mean absolute exemption from filing the notice. Above exemption notification from filing notice is subject to provisions contained under Section 6(2A) of the Act which envisages that no combination shall come into effect until 210 days have passed from the day of notice or the Commission has passed orders, whichever is earlier. Further, in terms of section

43A of the Act, if any person or enterprise who fails to give notice to the Commission under sub-section (2) of section 6, the Commission shall impose on such person or enterprise a penalty which may extend to one percent, of the total turnover or the assets, whichever is higher, of such a combination. Accordingly, requirement to file notice with the Commission is still mandatory.

***Notification regarding exemption of Regional Rural Banks from Section 5 and 6 of the Competition Act, 2002:***

Pursuant to Notification No. S.O. 2561 (E) dated August 10, 2017 the Central Government, in public interest, has exempted the Regional Rural Banks in respect of which the Central Government has issued a notification under sub-section (1) of section 23A of the Regional Rural Banks Act, 1976 (21 of 1976), from the application of provisions of sections 5 and 6 of the Competition Act, 2002 for a period of five years from the date of publication of this notification in the Official Gazette. Accordingly, the benefit of aforesaid exemption will be available for 5 (five) years from August 10, 2017 till August 10, 2022.

***Exemption of nationalized banks from Section 5 and 6 of the Competition Act, 2002:*** Pursuant to Notification No. S.O. 2828 (E) dated August 30, 2017, the Central Government in the public interest has exempted, all cases of reconstitution, transfer of the whole or any part thereof and amalgamation of nationalized banks, under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 (5 of 1970) and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 (40 of 1980), from the application of provisions of Sections 5 and 6 of the Competition Act, 2002 for a period of ten years from the date of publication of this notification in the Official Gazette. Accordingly, the benefit of aforesaid exemption will be available for 10 (ten) years from August 30, 2017 till August 30, 2027.

***Exemption of Combination under Section 5 of the Act involving Central Public Sector Enterprises (CPSEs) operating in the Oil and Gas Sectors:*** Pursuant to Notification No. S.O. 3714(E) dated November 22, 2017, the Central Government in the public interest has exempted all cases of combinations under section 5 of the Act involving the Central Public Sector Enterprises (CPSEs) operating in the Oil and Gas Sectors under the Petroleum Act, 1934 (30 of 1934) and the rules made thereunder or under the Oilfields (Regulation and Development) Act, 1948 (53 of 1948) and the rules made thereunder, along with their wholly or partly owned subsidiaries operating in the Oil and Gas Sectors, from the application of the provisions of sections 5 and 6 of the Act, for a period of five years from the date of publication of notification in the Official Gazette. Accordingly, the benefit of aforesaid exemption will be available for 5 (five) years from November 22, 2017 till November 22, 2022.

***Categories of transactions not likely to have appreciable adverse effect on competition & Notice need not normally be filed:*** Regulation 4 of the Competition Commission of India (Procedure in regard to the transaction of Business relating to Combinations) Regulations, 2011 ("**Combination Regulations**") relating to categories of transactions not likely to have appreciable adverse effect on competition in India clarifies that certain categories of combinations mentioned in Schedule I to the Combination Regulations are ordinarily not likely to cause an appreciable adverse effect on competition in India. Accordingly, notice under sub-section (2) of section 6 of the Act need not normally be filed. Following are categories of transactions listed under Schedule I.

1. An acquisition of shares or voting rights, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of section 5 of the Act, solely as an investment or in the ordinary course of business in so far as the total shares or voting rights held by the acquirer directly or indirectly, does not entitle the acquirer to hold twenty five per cent (25%) or more of the total shares or voting rights of the company, of which shares or voting rights are being acquired, directly or indirectly or in accordance with the execution of any document including a share holders' agreement or articles of association, not leading to acquisition of control of the enterprise whose shares or voting rights are being acquired. By way of guidance, Explanation to Item 1 provides that the acquisition of less than ten per cent of the total shares or voting rights of an enterprise shall be treated as solely as an investment. However, following conditions must be satisfied for the purposes of claiming exemption under Item 1 of Schedule I viz. (A) the Acquirer has ability to exercise only such rights that are exercisable by the ordinary shareholders of the enterprise whose shares or voting rights are being acquired to the extent of their respective shareholding; **and** (B) the Acquirer is not a member of the board of directors of the enterprise whose shares or voting rights are being acquired and does not have a right or intention to nominate a director on the board of directors of the enterprise whose shares or voting rights are being acquired and does not intend to participate in the affairs or management of the enterprise whose shares or voting rights are being acquired.

- 1A. An acquisition of additional shares or voting rights of an enterprise by the acquirer or its group, where the acquirer or its group, prior to acquisition, already holds twenty five per cent (25%) or more shares or voting rights of the enterprise, but does not hold fifty per cent (50%) or more of the shares or voting rights of the enterprise, either prior to or after such acquisition. However, for claiming this exemption, it is pertinent to note that such acquisition does not result in acquisition of sole or joint control of such enterprise by the acquirer or its group.
2. An acquisition of shares or voting rights, referred to in sub-clause (i) or sub-clause (ii) of clause (a) of section 5 of the Act, where the acquirer, prior to acquisition, has fifty percent (50%) or more shares or voting rights in the enterprise whose shares or voting rights are being acquired, except in the cases where the transaction results in transfer from joint control to sole control.
3. An acquisition of assets, referred to in sub- clause (i) or sub-clause (ii) of clause (a) of section 5 of the Act, not directly related to the business activity of the party acquiring the asset or made solely as an investment or in the ordinary course of business, not leading to control of the enterprise whose assets are being acquired except where the assets being acquired represent substantial business operations in a particular location or for a particular product or service of the enterprise, of which assets are being acquired, irrespective of whether such assets are organized as a separate legal entity or not.
4. An amended or renewed tender offer where a notice to the Commission has been filed by the party making the offer, prior to such amendment or renewal of the offer. However, for claiming this exemption, it is pertinent to note that compliance with regulation 16 relating to intimation of any change is duly made.
5. An acquisition of stock-in-trade, raw materials, stores and spares, trade receivables and other similar current assets in the ordinary course of business.
6. An acquisition of shares or voting rights pursuant to a bonus issue or stock splits or consolidation of face value of shares or buy back of shares or subscription to rights issue of shares, not leading to acquisition of control.
7. Any acquisition of shares or voting rights by a person acting as a securities underwriter or a registered stock broker of a stock exchange on behalf of its clients, in the ordinary course of its business and in the process of underwriting or stock broking, as the case may be.
8. An acquisition of shares or voting rights or assets, by one person or enterprise, of another person or enterprise within the same group, except in cases where the acquired enterprise is jointly controlled by enterprises that are not part of the same group.
9. A merger or amalgamation of two enterprises where one of the enterprises has more than fifty per cent (50%) shares or voting rights of the other enterprise, and/or merger or amalgamation of enterprises in which more than fifty per cent (50%) shares or voting rights in each of such enterprises are held by enterprise(s) within the same group. However, for claiming this exemption, it is pertinent to note that transaction does not result in transfer from joint control to sole control.
10. Acquisition of shares, control, voting rights or assets by a purchaser approved by the Commission pursuant to and in accordance with its order under section 31 of the Act.

**Form of notice:** Regulation 5 of the Combination Regulations relating to form of notice for the proposed combination provides that the notice under sub-section (2) of section 6 of the Act, shall ordinarily be filed in Form I as specified in schedule II to the Combination Regulations. Regulation 5 further provides that the parties to the combination may, at their option, give notice in Form II, as specified in schedule II to Combination regulations, preferably in the instances where- (a) the parties to the combination are engaged in production, supply, distribution, storage, sale or trade of similar or identical or substitutable goods or provision of similar or identical or substitutable services and the combined market share of the parties to the combination after such combination is more than fifteen percent (15%) in the relevant market; (b) the parties to the combination are engaged at different stages or levels of the production chain in different markets, in respect of production, supply, distribution, storage, sale or trade in goods or provision of services, and their individual or combined market share is more than twenty five percent (25%) in the relevant market. However, in terms of Regulation 5 (5), it is pertinent to note that in cases where the parties to the combination have filed notice in Form I and the Commission requires information in Form II to form its *prima facie* opinion whether the combination is likely to cause or has caused appreciable adverse effect on competition

within the relevant market, it shall direct the parties to the combination to file notice in Form II as specified in schedule II to combination regulations.

**Obligation to file the notice:** Regulation 9 of the Combination Regulations relating to obligation to file the notice provides that in case of an acquisition or acquiring of control of enterprise(s), the acquirer shall file the notice in Form I or Form II, as the case may be. Regulation 9 further provides that in case of a merger or an amalgamation, parties to the combination shall jointly file the notice in Form I or Form II, as the case may be.

**Suspensory regime:** Section 6(2A) of the Act envisages that no combination shall come into effect until 210 days have passed from the day of notice or the Commission has passed orders, whichever is earlier. In other words, there is requirement to receive approval of the Commission prior to closing of the transaction.

**Review of combination by Commission:** The Competition Commission of India (CCI) has been empowered to deal with such notice in accordance with provisions of Sections 29, 30 and 31 of the Act. Section 29 prescribes procedure for investigation of combinations. Section 30 empowers the Commission to determine whether the disclosure made to it under Section 6(2) is correct and whether the combination has, or is likely to have, an appreciable adverse effect on the competition. Section 31 provides that the Commission may allow the combination if it will not have any appreciable adverse effect on competition or pass an order that the combination shall not take effect, if in its opinion, such a combination has or is likely to have an appreciable adverse effect on competition.

**Non applicability of section 6:** The provisions of Section 6 do not apply to share subscription or financing facility or any acquisition, by a public financial institution, foreign institutional investor, bank or venture capital fund, pursuant to any covenant of a loan agreement or investment agreement. This exemption appears to have been provided in the Act to facilitate raising of funds by an enterprise in the course of its normal business. Under Section 6(5), the public financial institution, foreign institutional investor, bank or venture capital fund, are required to file in prescribed form, details of the control, the circumstances for exercise of such control and the consequences of default arising out of loan agreement or investment agreement, within seven days from the date of such acquisition or entering into such agreement, as the case may be.

As per the explanation appended to Section 6(5)

- (a) "foreign institutional investor" has the same meaning as assigned to it in clause (a) of the Explanation to Section 115AD of the Income-tax Act, 1961;
- (b) "venture capital fund" has the same meaning as assigned to it in clause (b) of the Explanation to clause (23 FB) of Section 10 of the Income-tax Act, 1961.

It may be noted that under the law, the combinations are only regulated whereas anti-competitive agreements and abuse of dominance are prohibited. Further, under the MRTP Act prior to 27.9.91, undertakings of certain size were required to be registered and such undertakings were required to seek prior approval of the Central Government before embarking upon expansion plans. In the present Act, there is no requirement of registration of an undertaking and further, there is no need to have prior approval of the Central Government but CCI will only examine as to whether or not combination is or is likely to have an appreciable adverse effect on competition.

The Competition Act with many innovative concepts coupled with power to impose fine is likely to let in harsh glare of sunlight to disinfect pernicious anti-competitive practices.

## Competition Commission of India

### Establishment of Commission

The Central Government under Section 7 has been empowered to establish a Commission to be called "Competition Commission of India" by issue of a Notification. The Commission is a body corporate having perpetual succession and a common seal. The Commission has power to acquire, hold movable or immovable property and to enter into contract in its name and by the said name, sue or be sued. In the premises, the set up of Commission corresponds to that of Securities & Exchange Board of India constituted under the SEBI Act, 1992.

The Head Office of the Commission shall be at such place as the Central Government may decide from time to time. Vide Notification: SO 1198(E) dated 14th Oct., 2003, the Central Government established the Competition Commission of India having its Head Office at New Delhi.

The Commission has also been authorized to establish its office at other places in India. Thus, the law provides for setting up of CCI's offices at places other than that of its Headquarter.

### ***Composition of Commission***

The composition of the Commission as spelled out under Section 8 of the Act consists of a Chairperson and not less than two and not more than six other Members. The Chairperson and the Members are to be appointed by the Central Government. Regarding the qualifications of the Chairman and other Members, Section 8(2) provides that they shall be person of ability, integrity and standing and who has special knowledge of and such professional experience of not less than fifteen years in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy which in the opinion of the Central Government, may be useful to the Commission. The Chairperson and other Members are to be appointed on whole time basis.

### ***Selection of Chairperson and Members of Commission***

Section 9(1) envisages that the Chairperson and other Members of the Commission shall be appointed by the Central Government from a panel of names recommended by a Selection Committee consisting of the Chief Justice of India or his nominee, as Chairperson; and the Secretary in the Ministry of Corporate Affairs, Member; the Secretary in the Ministry of Law and Justice, Member; and two experts of repute who have special knowledge of, and professional experience in international trade, economics, business, commerce, law, finance, accountancy, management, industry, public affairs or competition matters including competition law and policy, as member.

### ***Term of office of Chairperson and other Members***

The Act stipulates that the Chairperson and every other Member shall hold office as such for a term of five years from the date on which he enters upon his office and shall be eligible for re-appointment. However, the Chairperson or other Members shall not hold office as such after he has attained the age of sixty-five years.

A vacancy caused by the resignation or removal of the Chairperson or any other Member under section 11 or by death or otherwise shall be filled by fresh appointment in accordance with the provisions of sections 8 and 9. The Chairperson and every other Member shall, before entering upon his office, make and subscribe to an oath of office and of secrecy in such form, manner and before such authority, as may be prescribed.

In the event of the occurrence of a vacancy in the office of the Chairperson by reason of his death, resignation or otherwise, the senior-most Member shall act as the Chairperson, until the date on which a new Chairperson, appointed in accordance with the provisions of this Act to fill such vacancy, enters upon his office. When the Chairperson is unable to discharge his functions owing to absence, illness or any other cause, the senior-most Member shall discharge the functions of the Chairperson until the date on which the Chairperson resumes the charge of his functions.

### ***Resignation of Chairperson etc.***

It has been provided under section 11 that the Chairperson or any other Member may resign his office by notice in writing under his hand addressed to the Central Government. However, until the Chairperson or a Member is permitted by the Central Government to relinquish his office, he will continue to hold his office until the expiry of three months from the date of receipt of such notice or until a person duly appointed as a successor enters into his office or until the expiry of his term, whichever is the earliest. Under Section 11(2), it is provided that in the following circumstances the Central Government may, by order, remove the Chairperson or any Member from his office if such Chairman or Member as the case may be, -

- (a) is, or at any time has been, adjudged as an insolvent; or
- (b) has engaged at any time, during his term of office, in any paid employment; or
- (c) has been convicted of an offence which, in the opinion of the Central Government, involves moral turpitude; or
- (d) has acquired such financial or other interest as is likely to affect prejudicially his functions as a Member; or
- (e) has so abused his position as to render his continuance in office prejudicial to the public interest; or
- (f) has become physically or mentally incapable of acting as a Member.

However, no Member shall be removed from his office on the ground that he has acquired such financial or other interest as is likely to affect prejudicially his function as a Member or has so abused his position as to render his continuance in public office prejudicial to the public interest unless the Supreme Court, on a reference being made to it in this behalf by the Central Government, has on an inquiry as prescribed reported that the Member ought on such ground or grounds to be removed.

Section 12 provides that for a period of two years from the date on which the Chairperson and other Member cease to hold office shall not accept any appointment in or connected with the management or administration of, any enterprise which has been a party to the proceeding before the Commission. This restriction, however, shall not apply to any employment under the Central Government or a State Government or local authority or any corporation established by or under any Central, State or Provincial Act or a Government company as defined under the Companies Act.

### **Appointment of Director General**

Director General is an important functionary under the Act. He is to assist the Commission in conducting inquiry into contravention of any of the provisions of the Act and for performing such other functions as are, or may be, provided by or under the Act.

Section 16 (1) empowers the Central Government to appoint a Director General and such number of additional, joint, deputy or assistant Director Generals or other advisers, consultants or officers for the purposes of assisting the Commission in conducting inquiry into the contravention of any provision of the Act.

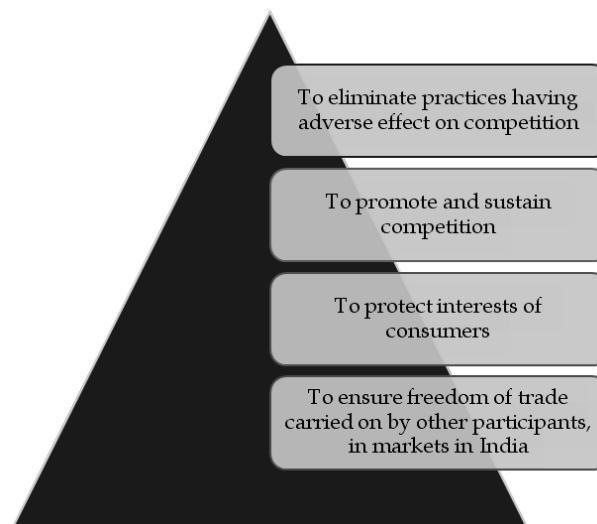
Additional, joint, deputy and assistant Director Generals, other advisors, consultants and officers shall however, exercise powers and discharge functions subject to the general control, supervision and directions of the Director General.

The salary, allowances and other terms and conditions and service of Director General, consultants, advisors or other officers assisting him shall be such as may be prescribed by the Central Government. The Director General, advisers, consultants and officers assisting him are to be appointed from amongst the persons of integrity and outstanding ability and who have experience in investigation, and knowledge of accountancy, management, business, public administration, international trade, law or economics and such other qualifications as may be prescribed.

The Commission may appoint a Secretary and such officers and other employees, as it considers necessary for the efficient performance of his functions under the Act. The Commission may engage, in accordance with the procedure specified by regulations, such number of experts and professionals of integrity and outstanding ability, who have special knowledge of, and experience in, economics, law, business or such other disciplines related to competition, as it deems necessary to assist the Commission in the discharge of its functions under the Act.

### **Duties, Powers and Functions of Commission**

As per Section 18 of the Act, duties of the CCI are:-



Section 18 empowers the Commission to enter into any memorandum or arrangement, with the prior approval of the Central Government, for the purpose of discharging the duties and functions under this Act with any agency of any foreign country. This will enable the CCI to have extra territorial reach and shall facilitate exchange of information and enforcement of its order.

### Inquiry into certain agreements and dominant position of enterprise

The Commission may inquire into any alleged contravention of Section 3(1) or 4(1) on its own motion or on

- (a) receipt of any information in such manner and accompanied by such fee, from any person, consumer or consumer association or trade association; or
- (b) a reference made to it by the Central Government or State Government or a statutory authority.

The Director General is not vested with a right to move an application for institution of an enquiry relating to anti-competitive agreements or abuse of dominance.

The terms 'person' and 'statutory authority' have been defined under Sections 2(l) and 2(w) respectively. The term 'person' has been given wide connotation and it includes an individual, a HUF, a company, a firm, an association of persons, any corporation established under any Central, State or Provincial Act or a Government company, a co-operative society, a local authority and every artificial juridical person.

***Section 19(3) provides that while determining whether an agreement has appreciable adverse effect on competition, the Commission shall give due regard to all or any of the following factors, namely-***

- (a) creation of barriers to new entrants in the market;
- (b) driving existing competitors out of the market;
- (c) foreclosure of competition by hindering entry into the market;
- (d) accrual of benefits to consumers;
- (e) improvements in production or distribution of goods or provision of services;
- (f) promotion of technical, scientific and economic development by means of production or distribution of goods or provision of services.

The first three factors are anti-competitive, while the latter three factors deal with benign effects.

"Adverse appreciable affect on competition" is a key factor while enquiring into anti-competitive agreement. The touch stone of appreciable adverse effect on competition need not be proved while enquiring into abuse of dominance.

***For the purpose of determining whether an enterprise enjoys dominant position or not under Section 4, the Commission shall have due regard to all or any of the following factors, namely-***

- (a) market share of the enterprise;
- (b) size and resources of the enterprise;
- (c) size and importance of the competitors;
- (d) economic power of the enterprise including commercial advantages over competitors;
- (e) vertical integration of the enterprises or sale or service network of such enterprises;
- (f) dependence of consumers on the enterprise;
- (g) monopoly or dominant position whether acquired as a result of any statute or by virtue of being a Government company or a public sector undertaking or otherwise;
- (h) entry barriers including barriers such as regulatory barriers, financial risk, high capital cost of entry, marketing entry barriers, technical entry barriers, economies of scale, high cost of substitutable goods or service for consumers;
- (i) countervailing buying power;
- (j) market structure and size of market;
- (k) social obligations and social costs;
- (l) relative advantage, by way of the contribution to the economic development, by the enterprise enjoying a dominant position having or likely to have an appreciable adverse effect on competition;
- (m) any other factor which the Commission may consider relevant for the inquiry.

The present law makes explicit the issues and the parameters which will be considered while deciding “abuse of dominance”. The Commission shall have due regard to the, “relevant geographic market” and “relevant product market” for determining as to what constitutes a “relevant market”.

The terms ‘relevant market’ and “relevant geographic market” have been defined in Sections 2 (r) and 2(s) of the Act. **For determining the “relevant geographic market”, the Commission shall have due regard to all or any of the following factors, namely;—**

- (a) regulatory trade barriers;
- (b) local specification requirements;
- (c) national procurement policies;
- (d) adequate distribution facilities;
- (e) transport costs;
- (f) language;
- (g) consumer preferences;
- (h) need for secure, regular supplies or rapid after-sales service.

Similarly, while determining ‘relevant product market’ the Commission shall have due regard to all or any of the following factors namely;

- (a) physical characteristics or end-use of goods;
- (b) price of goods or service;
- (c) consumer preferences;
- (d) exclusion of in-house production;
- (e) existence of specialized producers;
- (f) classification of industrial products.

The prescription of parameters for determining “appreciable adverse effect” on competition of agreement, “dominant position”, within “relevant market”, are intended to bring consistency and certainty in the working of the Commission which has to consider all or any of the applicable factors, as the case may be. It is quite apparent that any inquiry by the CCI will be a detailed exercise, which will not only involve gathering of information in regard to technological or marketing factors but also the government policy which relate to the trade or business in which the enterprise is involved beside global scenario especially with regard to regulatory trade barriers including import-export policy, tariff and subsidy issues will also be taken into account by the Commission.

### **Inquiry into Combination by Commission**

The Commission under Section 20 of the Competition Act may inquire into the appreciable adverse effect caused or likely to be caused on competition in India as a result of combination either upon its own knowledge or information (suo motu) or upon receipt of notice under Section 6(2) relating to acquisition referred to in Section 5(a) or acquiring of control referred to in Section 5(b) or merger or amalgamation referred to in Section 5(c) of the Act. It has also been provided that an enquiry shall be initiated by the Commission within one year from the date on which such combination has taken effect. Thus, the law has provided a time limit within which suo moto inquiry into combinations can be initiated. This provision dispels the fear of enquiry into combination between merging entities after the expiry of stipulated period.

On receipt of the notice under Section 6(2) from the person or an enterprise which proposes to enter into a combination, it is mandatory for the Commission to inquire whether the combination referred to in that notice, has caused or is likely to cause an appreciable adverse effect on competition in India.

***The Commission shall have due regard to all or any of the factors for the purposes of determining whether the combination would have the effect of or is likely to have an appreciable adverse effect on competition in the relevant market, namely –***

- (a) actual and potential level of competition through imports in the market;
- (b) extent of barriers to entry into the market;
- (c) level of combination in the market;
- (d) degree of countervailing power in the market;
- (e) likelihood that the combination would result in the parties to the combination being able to significantly and sustainably increase prices or profit margins;
- (f) extent of effective competition likely to sustain in a market;
- (g) extent to which substitutes are available or are likely to be available in the market;
- (h) market share, in the relevant market, of the persons or enterprise in a combination, individually and as a combination;
- (i) likelihood that the combination would result in the removal of a vigorous and effective competitor or competitors in the market;
- (j) nature and extent of vertical integration in the market;
- (k) possibility of a failing business;
- (l) nature and extent of innovation;
- (m) relative advantage, by way of the contribution to the economic development, by any combination having or likely to have appreciable adverse effect on competition;
- (n) whether the benefits of the combination outweigh the adverse impact of the combination, if any.

The above yardsticks are to be taken into account irrespective of fact whether an inquiry is instituted, on receipt of notice under Section 6(2) upon its own knowledge. The scope of assessment of adverse effect on competition will be confined to the “relevant market”. Most of the facts enumerated in Section 20 (4) are external to an enterprise. It is noteworthy that sub clause (n) of Section 20 (4) requires to invoke principles of a “balancing”. It requires the Commission to evaluate whether the benefits of the combination outweigh the adverse impact of the combination, if any. In other words if the benefits of the combination outweigh the adverse effect of the combination, the Commission will approve the combination. Conversely, the Commission may declare such a combination as void. In this regard, following must also be noted. Section 31 (1) provides that where the Commission is of the opinion that any combination does not, or is not likely to, have an appreciable adverse effect on competition, it shall, by order, approve that combination including the combination in respect of which a notice has been given under sub-section (2) of section 6. Section 31 (2) provides that where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition, it shall direct that the combination shall not take effect. However, Section 31 (3) provides that where the Commission is of the opinion that the combination has, or is likely to have, an appreciable adverse effect on competition but such adverse effect can be eliminated by suitable modification to such combination, it may propose appropriate modification to the combination, to the parties to such combination.

### **Reference by statutory authority**

The term “statutory authority” has been defined in Section 2(w). If in the course of a proceeding before any statutory authority, an issue is raised by any party that any decision which such authority has taken or proposes to take, is or would be, contrary to the provisions of the Competition Act 2002, it may make a reference in respect of such issue to the Commission and seek its opinion. The Commission shall, on receipt of the reference, after hearing the parties to the proceedings, give its opinion within 60 days of receipt of such reference to such authority on the issues referred to it. The statutory authority shall thereafter pass such order on the issues referred to the Commission as it deems fit. The statutory authority may, *suo motu* make such reference in respect of such issue to the Commission.

Likewise, the Commission either in the course of proceedings before it or *suo motu* may make a reference for opinion to a statutory authority and the latter has to render its opinion within 60 days of making a reference.

### Meetings of Commission

Section 22 provides that the Commission shall meet at such times and places, and shall observe such rules and procedure in regard to the transaction of business at its meetings as may be provided by regulations. The Chairperson, if for any reason, is unable to attend a meeting of the Commission, the senior-most Member present at the meeting, shall preside at the meeting. All questions which come up before any meeting of the Commission shall be decided by a majority of the Members present and voting, and in the event of an equality of votes, the Chairperson or in his absence, the Member presiding, shall have a second or/casting vote. However, the quorum for such meeting shall be three Members.

### Procedure for inquiry on complaints under Section 19

If the Commission is of the opinion that there exists a *prima facie* case, on receipt of an information from any person, consumer, their association or trade association or on a reference from Central Government or State Government or of a statutory authority or on its knowledge or information under Section 19, it shall direct the Director General to cause an investigation to be made into the matter. The Director General shall investigate into the matter and submit a report of its findings within the period as may be specified by the Commission. It is, however, not binding on the Commission to accept the report of the Director General.

Where upon receipt of a reference or information, the Commission is of the opinion that there is no *prima-facie* case, it shall pass an order dismissing the reference/information, as it deems fit and necessary.

Upon receipt of a report from the Director General, the Commission shall forward a copy thereof to (a) the parties concerned or (b) Central Government or (c) State Government or (d) statutory authority as the case may be. If the Director General, in relation to a matter referred to it, recommends that there is no contravention of any of the provisions of the Act, the Commission shall give an opportunity of hearing to the informant and after hearing, if the Commission agrees with the recommendation of the Director General, it shall dismiss the information. According to Section 26(7) if, after hearing information provider, the Commission is of the opinion that further inquiry is called for, it shall direct the enquiry to proceed further.

Where the report of the Director General relates to matter referred to Commission by the Central Government or a State Government or a statutory authority and the report contains recommendation that there is no contravention of the provisions of the Act, the Commission shall invite the comments of the Central Government or the State Government or statutory authority, as the case may be, on such report. On receipt of the comments, if there is no *prima-facie* case, in the opinion of the Commission the Commission shall return the reference. However, if the Commission feels that there is a *prima-facie* case it shall proceed with a reference.

Section 26(9) provides that the Commission on receipt of recommendation of Director General that there is contravention of any of the provisions of the Act, and a further inquiry is called for, shall inquire into such contravention in accordance with the provisions of the Act.

The provisions of the Section indicate that it is mandatory that information or reference received or a matter which comes to the knowledge of the Commission regarding alleged violation of the provisions of the Act, must be referred to the Director General for an investigation in the matter. A copy of the report of the Director General is required to be sent to the information provider or to the Central Government or State Government or a statutory authority, as the case may be, for their comments and an opportunity of hearing is required to be given to the parties as this is warranted by the principles of natural justice. Where the Director General recommends that there is contravention of any of the provisions of the Act, and that the Commission is of opinion that further inquiry is called for, it shall institute an inquiry into the matter and pass a reasoned order. The Commission may or may not subscribe to the recommendations of the Director General.

### Orders by Commission after inquiry into agreements or abuse of dominant position

Section 27 envisages that the Commission after any inquiry into agreement entered into by any enterprise or association of enterprises or person or association of persons, or an inquiry into abuse of dominant position may pass all or any of the following orders, namely, –

- (i) direct that such agreement, or abuse of dominant position shall be discontinued and such agreement, which is in contravention of Section 3 shall not be re-entered or the abuse of dominant position in contravention of Section 4 shall be discontinued, as the case may be. The direction to discontinue and not to recur is commonly known as "Cease & desist" order.
  - (ii) the Commission may impose penalty not exceeding ten percent of the average turnover of last three preceding financial years, upon each of person or enterprises which are parties to such agreement in contravention of Section 3 or are abusing dominant position within meaning of Section 4.
- In case any agreement which is prohibited by Section 3 has been entered into by any cartel, the Commission may impose upon each producer, seller, distributor, trader or service provider participating in that cartel, a penalty up to three times of its profits for each year of the continuance of such agreement whichever is higher.
- (iii) The Commission may direct that the agreements shall stand modified to the extent and in the manner as specified in the order.
  - (iv) The Commission may direct the enterprises concerned to comply with such other orders and directions, including payment of cost, if any, as it deems fit.
  - (v) to pass such order or issue such directions as it may deem fit.

### Relevant turnover for determining penalty under section 27 of the Act

In *Excel Crop Care Limited Vs Competition Commission of India & Another (Civil Appeal No. 2480 of 2014, judgment dated May 08, 2017)*, Hon'ble Supreme Court of India observed that a plain reading of Section 27 (b) elucidates that the commission is empowered to impose penalty and to the extent as it deems fit but not exceeding ten percent of the turnover. Section 27 (b) emphasize that penalty is to be levied on 'person or enterprise' who have contravened Section 3 or Section 4 of the Act. Supreme Court emphasized on the usage of the phrase '*as it may deem fit*' as occurring under Section 27 of the Act. At the outset this phrase is indicative of the discretionary power provided for the fining authority under the Act. As the law abhors absolute power and arbitrary discretion, this discretion provided under Section 27 needs to be regulated and guided so that there is uniformity and stability with respect to imposition of penalty. This discretion should be governed by rule of law and not by arbitrary, vague or fanciful considerations. Supreme Court noted that any penal law imposing punishment is made for general good of the society. As a part of equitable consideration, we should strive to only punish those who deserve it and to the extent of their guilt. Further it is well established by this Court that the principle of proportionality requires the fine imposed must not exceed what is appropriate and necessary for attaining the object pursued.

In the aforesaid context, Hon'ble Supreme Court observed that in consonance of established jurisprudence, the principle of proportionality needs to be imbibed into any penalty imposed under Section 27 of the Act. Otherwise excessively high fines may over-deter, by discouraging potential investors, which is not the intention of the Act. Therefore the fine under Section 27(b) of the Act should be determined on the basis of the relevant turnover. Supreme Court laid out a two step calculation that has to be followed while imposing the penalty under Section 27 of the Act. Under Step 1 relating to determination of relevant turnover, Hon'ble Supreme Court observed that at this point of time it needs to be clarified that relevant turnover is the entity's turnover pertaining to products and services that have been affected by such contravention. The aforesaid definition is not exhaustive. The authority should have regard to the entity's audited financial statements. Where audited financial statements are not available, the Commission may consider any other reliable records reflecting the entity's relevant turnover or estimate the relevant turnover based on available information. However the Tribunal is free to consider facts and circumstances of a particular case to calculate relevant turnover as and when it is seized with such matter. Under Step 2 relating to determination of appropriate percentage of penalty based on aggravating and mitigating circumstances, Hon'ble Supreme Court observed that after such initial determination of relevant turnover, commission may consider appropriate percentage, as the case may be, by taking into consideration nature, gravity, extent of the contravention, role played by the infringer, the duration of participation, the intensity of participation, loss or damage suffered as a result of such contravention, market circumstances in which the contravention took place, nature of the product, market share of the entity, barriers to entry in the market, nature of involvement of the company, bona fides of the company, profit derived from the contravention etc. These factors are only illustrative for the tribunal to take into consideration while imposing appropriate percentage of penalty. Accordingly, Supreme Court observed that at the cost of repetition it should be noted that starting point of determination of appropriate penalty should be to

determine relevant turnover and thereafter the tribunal should calculate appropriate percentage of penalty based on facts and circumstances of the case taking into consideration various factors while determining the quantum. But such penalty should not be more than the overall cap of 10% of the entity's relevant turnover. Such interpretation of Section 27 (b) of the Act, wherein the discretion of the commission is guided by principles established by law would sub-serve the intention of the enactment.

### **Division of enterprise enjoying dominant position**

The Commission may, notwithstanding anything contained in any other law for the time being in force, by order in writing, direct division of an enterprise enjoying dominant position to ensure that such enterprise or group does not abuse its dominant position.

The order of the Commission referred to above may provide for all or any of the following matters, namely –

- (a) the transfer or vesting of property, rights, liabilities or obligations;
- (b) the adjustment of contracts either by discharge or reduction of any liability or obligation or otherwise;
- (c) the creation, allotment, surrender or cancellation of any shares, stocks or securities;
- (d) the formation or winding up of an enterprise or the amendment of the memorandum of association or articles of association or any other instruments regulating the business of any enterprise;
- (e) the extent to which, and the circumstances in which, provisions of the order affecting an enterprise may be altered by the enterprise and the registration thereof;
- (f) any other matter which may be necessary to give effect to the division of the enterprise or group.

### **Procedure for investigation of combination**

The procedure for investigation by the Commission has been stipulated under Section 29 of the Act. It involves following stages -

- (i) The Commission first has to form a *prima facie* opinion that a combination is likely to cause, or has caused an appreciable adverse effect on competition within the relevant market in India. Further, when the Commission has come to such a conclusion then it shall proceed to issue a notice to the parties to the combination, calling upon them to show cause why an investigation in respect of such combination should not be conducted;
- (ii) After receipt of the response of the parties to the combination Commission may call for the report of the Director General.
- (iii) When pursuant to response of parties or on receipt of report of the Director General whichever is later, the Commission *prima-facie* is of the opinion that the Combination is likely to cause an appreciable adverse effect on competition in relevant market, it shall, within seven days direct the parties to the combination to publish within ten working days, the details of the combination, in such manner as it thinks appropriate so as, to bring to the information of public and persons likely to be affected by such combination.
- (iv) The Commission may invite any person affected or likely to be affected by the said combination, to file his written objections within fifteen working days of the publishing of the public notice, with the Commission for its consideration.
- (v) The Commission may, within fifteen working days of the filing of written objections, call for such additional or other information as it deem fit from the parties to the said combination and the information shall be furnished by the parties above referred within fifteen days from the expiry of the period notified by the Commission.
- (vi) After receipt of all the information and within forty-five days from expiry of period for filing further information, the Commission shall proceed to deal with the case, in accordance with provisions contained in Section 31 of the Act.

Thus, the provisions of Section 29 provide for a specified timetable within which the parties to the combination or parties likely to be affected by the combination are required to submit the information or further information to the Commission to ensure prompt and timely conduct of the investigation. It further imposes on Commission a time

limit of forty-five working days from the receipt of additional or other information called for by it under sub-Section (4) of Section 29 for dealing with the case of investigation into a combination, which may have an adverse effect of the competition.

### **Inquiry into disclosures under Section 6(2)**

Section 6(2) casts an obligation on any person or enterprise, who or which proposes to enter into combination, shall give notice to the Commission, in the form as may be specified, and the fee which may be determined, by regulations, disclosing the details of the proposed combination within thirty days of—

- (i) approval of the proposal relating to merger or amalgamation by the board of directors of the enterprises concerned with such merger or amalgamation;
- (ii) execution of any agreement or other document for acquisition referred to in Section 5(a) or acquiring of control referred to in Section 5(b).

Non-filing of notice attracts penalty in terms of Section 43A of the Act.

Section 6(2A) envisages that no combination shall come into effect until two hundred and ten days have passed from the day on which notice has been given to Commission or the Commission has passed orders, whichever is earlier.

Upon receipt of such notice, the Commission shall examine such notice and form its *prima facie* opinion as to whether the combination has, or is likely to have, an appreciable adverse effect on the competition in the relevant market in India.

### **Orders of Commission on Certain Combinations**

The Commission, after consideration of the relevant facts and circumstances of the case under investigation, by it under Sections 28 or 30 and assessing the effect of any combination on the relevant market in India, may pass any of the written orders indicated herein below. Where the Commission comes to a conclusion that any combination does not, or is not likely to, have an appreciable adverse effect on the Competition in relevant market in India, it may, approve that Combination.

- (i) In the case where the Commission is of the opinion that the combination has, or is likely to have an adverse effect on competition, it shall direct that the combination shall not take effect.
- (ii) Where the Commission is of the opinion that adverse effect which has been caused or is likely to be caused on competition can be eliminated by modifying such Combination then it shall direct the parties to such combination to carry out necessary modifications to the Combination.
- (iii) The parties accepting the proposed modification shall carry out such modification within the period specified by the Commission.
- (iv) Where the parties who have accepted the modification, fail to carry out such modification within the period specified by the Commission, such combination shall be deemed to have an appreciable adverse effect on competition and shall be dealt with by the Commission in accordance with the provisions of the Act.
- (v) If the parties to the Combination do not accept the proposed modification such parties may within thirty days of modification proposed by the Commission, submit amendment to the modification proposed by the Commission.
- (vi) If the Commission agrees with the agreement submitted by the parties it shall, by an order approve the combination.
- (vii) If the Commission does not accept the amendment then, parties shall be allowed a further period of thirty days for accepting the amendment proposed by the Commission.
- (viii) Where the parties to the combination fail to accept the modification within thirty days, then it shall be deemed that the combination has an appreciable adverse effect on Competition and will be dealt with in accordance with the provisions of the Act.
- (ix) Where the Commission directs under Section 31 (2) that the combination shall not take effect or it has, or is likely to have an appreciable adverse effect, it may order that,

- (a) the acquisition referred to in Section 5 (a); or
- (b) the acquiring of control referred to in Section 5(b); or
- (c) the merger or the amalgamation referred to in Section 5(c) shall not be given effect to by the parties.

As per proviso the Commission may, if it considers appropriate, frame a scheme to implement its order in regard to the above matters under Section 31(10).

- (x) A deeming provision has been introduced by Section 31(11). It provides that, if the Commission does not, on expiry of a period of two hundred ten days from the date of filing of notice under Section 6(2) pass an order or issue any direction in accordance with the provisions of Section 29(1) or Section 29(2) or Section 29(7), the combination shall be deemed to have been approved by the Commission. In reckoning the period of two hundred ten days, the period of thirty days specified in Section 29(6) and further period of thirty working days specified in Section 29(8) granted by Commission shall be excluded.
- (xi) Further more where extension of time is granted on the request of parties the period of two hundred ten days shall be reckoned after deducting extended time granted at the request of the parties.
- (xii) Where the Commission has ordered that a combination is void, as it has an appreciable adverse effect on competition, the acquisition or acquiring of control or merger or amalgamation referred to in Section 5, shall be dealt with by other concerned authorities under any other law for the time being in force as if such acquisition or acquiring of control or merger or amalgamation had not taken place and the parties to the combination shall be dealt with accordingly.
- (xiii) Section 29(14) makes it clear that nothing contained in Chapter IV of the Act shall affect any proceeding initiated or may be initiated under any other law for the time being in force. It implies that provisions of this Act are in addition to and not in derogation of provisions of other Acts.

Thus, approval under one law does not make out a case for approval under another law.

### **Acts taking place outside India but having an effect on Competition in India**

Section 32 extends the jurisdiction of Competition Commission of India to inquire and pass orders in accordance with the provisions of the Act into an agreement or dominant position or combination, which is likely to have, an appreciable adverse effect on competition in relevant market in India, notwithstanding that,

- (a) an agreement referred to in Section 3 has been entered into outside India; or
- (b) any party to such agreement is outside India; or
- (c) any enterprise abusing the dominant position is outside India; or
- (d) a combination has taken place outside India; or
- (e) any party to combination is outside India; or
- (f) any other matter or practice or action arising out of such agreement or dominant position or combination is outside India.

The above clearly demonstrates that acts taking place outside India but having an effect on competition in India will be subject to the jurisdiction of Commission. The Competition Commission of India will have jurisdiction even if both the parties to an agreement are outside India but only if the agreement, dominant position or combination entered into by them has an appreciable adverse effect on competition in the relevant market of India.

### **Appearance before Commission**

As per Section 35 of the Act, following persons are entitled to appear before the Commission-

- (i) a complainant; or
- (ii) a defendant; or
- (iii) the Director General

They may either appear in person or authorise any of the following:

- (a) a chartered accountant as defined in Section 2(1)(b) of Chartered Accountants Act, 1949 (38 of 1949) who has obtained a certificate of practice; or
- (b) a company secretary as defined in Section 2(1)(c) of the Company Secretaries Act, 1980 (56 of 1980) and who has obtained a certificate of practice;
- (c) a cost accountant as defined in Section 2(1)(b) of the Cost and Works Accountants Act, 1959 (23 of 1959) and who has obtained a certificate of practice;
- (d) a legal practitioner that is an advocate, vakil or an attorney of any High Court including a pleader in practice.

 The above provisions unambiguously state that a 'Company Secretary in Practice' is entitled to represent an informant or a defendant or Director General. A Company Secretary in Practice can also get himself empanelled with the Director General to prosecute his cases before the Commission.

### Power of Commission to regulate its own procedure

The Competition Commission of India has been empowered to lay down its own procedure and regulations. It is not bound by the procedure laid down by the Code of Civil Procedure, 1908 but shall have to observe the principles of natural justice and subject to the provisions of the Act. The Competition Commission of India shall also be subject to the rules made by the Central Government. Section 36(2) makes it clear that the Commission shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying the suit, in respect of the following matters, namely:

Summoning and enforcing the attendance of any person and examining him on oath

Requiring the discovery and production of documents

Receiving evidence on affidavits

Issuing commissions for the examination of witnesses or documents

Subject to the provisions of Sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office

In terms of Section 36(3), the Commission may call upon such experts, from the field of economics, commerce, accountancy, international trade or from any discipline as it deems necessary to assist the Commission in the conduct of any enquiry by it.

In terms of Section 36(4), the Commission may direct any person –

- (a) to produce before the Director General or the Secretary or an officer authorized by it, such books, or other documents in the custody or under the control of such person so directed as may be specified or described in the direction, being documents relating to any trade, the examination of which may be required for the purposes of the Act;
- (b) to furnish to the Director General or the Secretary or any other officer authorized by it, as respects the trade or such other information as may be in his possession in relation to the trade carried on by such person, as may be required for the purposes of the Act.

The Competition Commission is thus empowered to appoint experts, from the fields of economics, commerce, accountancy, international trade or from any other discipline as it deems necessary, to assist in the conduct of any inquiry or proceeding before it.

As stated earlier, Director General is an important functionary assisting the Commission and the Commission may ask the Director General to investigate into any trade practice and for the purpose of examination of books, or account and other document of the parties concerned. The Director General is also vested with all the powers as are conferred upon the Commission under Section 36(2) of Act.

### Ratification of orders

The Commission may amend any order passed by it under the provisions of this Act with a view to rectifying any mistake apparent from the record. Section 38(2) provides that subject to other provisions of this Act, the Commission may make –

- (a) an amendment of an order of its own motion;
- (b) an amendment for rectifying any mistake apparent from record, which has been brought to its notice by any party to the order.

An explanation below the Section clarifies that while rectifying any mistake apparent from the record, the Commission shall not amend substantive part of the order passed by it under the provisions of this Act.

### Execution of Orders of the Commission Imposing Monetary penalty

Section 39 provides that if a person fails to pay any monetary penalty imposed on him under the Act, the Commission shall proceed to recover such penalty, in such manner as may be specified by the regulations. In a case where the Commission is of the opinion that it would be expedient to recover the penalty imposed under the Act in accordance with the provisions of the Income-tax Act, 1961, it may make a reference to this effect to the concerned income-tax authority under that Act for recovery of the penalty as tax due under the said Act.

Where a reference has been made by the Commission under sub-section (2) for recovery of penalty, the person upon whom the penalty has been imposed shall be deemed to be the assessee in default under the Income Tax Act, 1961 and the provisions contained in sections 221 to 227, 228A, 229, 231 and 232 of the said Act and the Second Schedule to that Act and any rules made there under shall, in so far as may be, apply as if the said provisions were the provisions of this Act and referred to sums by way of penalty imposed under this Act instead of to income-tax and sums imposed by way of penalty, fine, and interest under the Income-tax Act, 1961 and to the Commission instead of the Assessing Officer.

*Explanation 1* – Any reference to sub-section (2) or sub-section (6) of section 220 of the income-tax Act, 1961 (43 of 1961), in the said provisions of that Act or the rules made thereunder shall be construed as references to sections 43 to 45 of this Act.

*Explanation 2* – The Tax Recovery Commissioner and the Tax Recovery Officer referred to in the Income- tax Act, 1961 shall be deemed to be the Tax Recovery Commissioner and the Tax Recovery Officer for the purposes of recovery of sums imposed by way of penalty under this Act and reference made by the Commission under sub-section (2) would amount to drawing of a certificate by the Tax Recovery Officer as far as demand relating to penalty under this Act.

*Explanation 3* – Any reference to appeal in Chapter XVIID and the Second Schedule to the Income-tax Act, 1961 shall be construed as a reference to appeal before the Competition Appellate Tribunal under section 53B of this Act.

It would be noted that Commission may by its Regulations has been empowered to evolve procedure of recovering monetary penalty. It may also make reference to Income Tax Authority for recovering of penalty as tax due under the said Act.

### Duties of Director General

The Act provides that the Director General when so directed by the Commission, is to assist the Commission in investigation into any contravention of the provisions of this Act. The Director General is bound to comply with such a direction to render requisite assistance to the Commission.

The Director General, in order to effectively discharge his functions, has been given the same powers as are conferred upon the Commission under section 36(2). Under section 36(2) the Commission is having same powers as are vested in Civil Court under the Code of Civil Procedure (1908) while trying a suit, in respect of the following matters, namely;

- (a) summoning and enforcing the attendance of any person and examining him on oath;
- (b) requiring the discovery and production of documents;
- (c) receiving evidence on affidavits;
- (d) issuing commissions for the examination of witnesses or documents;
- (e) subject to the provisions of Sections 123 and 124 of the Indian Evidence Act, 1872, requisitioning any public record or document or copy of such record or document from any office;

Without prejudice to the above powers, the provisions of Sections 240 and 240A of the Companies Act, 1956, so far as may be, shall apply to an investigation made by the Director General or by a person authorised by him, as they apply to an inspector under the Companies Act 1956. This power includes search and seizure of the record of any person in respect of which an investigation has been directed by the Commission. It has been provided that wherever the approval of the Central Government is required, the same shall be given by the Commission and the word 'magistrate' appearing in Section 240A shall be construed as the Chief Metropolitan Magistrate.

### **Penalties**

The Competition Act prescribes penalties for contravention of orders of the Commission. As per Section 42 (1) the Commission may cause an inquiry to be made into compliance of its orders or directions made in exercise of its powers under the Act.

Section 42(2) provides that if any person, without reasonable cause, fails to comply with the orders or directions of the Commission issued under sections 27, 28, 31, 32, 33, 42A and 43A of the Act, he shall be punishable with fine which may extend to rupees one lakh for each day during which such non-compliance occurs, subject to a maximum of rupees ten crore, as the Commission may determine.

Further, Section 42(3) states that if any person does not comply with the orders or directions issued, or fails to pay the fine imposed under sub-section (2), he shall, without prejudice to any proceeding under section 39, be punishable with imprisonment for a term which may extend to three years, or with fine which may extend to rupees twenty-five crore, or with both, as the Chief Metropolitan Magistrate, Delhi may deem fit:

Provided that the Chief Metropolitan Magistrate, Delhi shall not take cognizance of any offence under this section save on a complaint filed by the Commission or any of its officers authorised by it.

### **COMPENSATION IN CASE OF CONTRAVENTION OF ORDERS OF COMMISSION**

Section 42A provides that without prejudice to the provisions of this Act, any person may make an application to the Appellate Tribunal for an order for the recovery of compensation from any enterprise for any loss or damage shown to have been suffered, by such person as a result of the said enterprise violating directions issued by the Commission or contravening, without any reasonable ground, any decision or order of the Commission issued under sections 27, 28, 31, 32 and 33 or any condition or restriction subject to which any approval, sanction, direction or exemption in relation to any matter has been accorded, given, made or granted under this Act or delaying in carrying out such orders or directions of the Commission.

### **Penalty for failure to comply with directions of Commission and Director General**

Section 43 of the Act provides that if any person fails to comply, without reasonable cause, with a direction given by the Commission under Sub-sections (2) and (4) of section 36; or the Director General while exercising powers referred to in sub-section (2) of section 41, such person shall be punishable with fine which may extend to rupees one lakh for each day during which such failure continues subject to a maximum of rupees one crore, as may be determined by the Commission

### Power to impose penalty for non-furnishing of information on combination

Section 43A provides that if any person or enterprise who fails to give notice to the Commission under sub-section(2) of section 6, the Commission shall impose on such person or enterprise a penalty which may extend to one per cent of the total turnover or the assets, whichever is higher, of such a combination.

Thus, failure to file notice of combination falling under Section 5 attract deterrent penalty.

### Penalty for making false statement

Section 44 provides that If any person, being a party to a combination, makes a statement which is false in any material particular, or knowing it to be false; or omits to state any material particular knowing it to be material, such person shall be liable to a penalty which shall not be less than rupees fifty lakhs but which may extend to rupees one crore, as may be determined by the Commission.

### Power to impose lesser penalty

If any producer, seller, distributor, trader or service provider included in any cartel, which is alleged to have violated Section 3, has made a full and true disclosure in respect of alleged violations and such a disclosure is vital, the Commission may impose upon him a lesser penalty than as prescribed under the Act or rules or regulations.

However, the lesser penalty shall not be imposed where before making such disclosure, the report of Director General under Section 26 has been received in the Commission. Further, the lesser penalty shall be imposed only in respect of the producer, seller, distributor, trader or service provider included in the cartel, who has made a full, true and vital disclosures under this Section. Any producer, seller, trader or service provider included in the cartel shall also be liable to imposition of penalty, if in the course of proceedings, had, –

- (a) not complied with the condition on which the lesser penalty was imposed by the Commission; or
- (b) given false evidence; or
- (c) the disclosure made is not vital.

The lesser penalty is for a member of a ring who breaks the rank. There is no provision to provide any protection or incentive to a whistle blower, which is conferred upon Authorities in contemporary legislations abroad.

### Contravention by Companies

A company means a body corporate and includes a firm or other association of individuals; director, in relation to a firm, means a partner in the firm for the purposes of penalties in connection with contravention of the provisions of the Act by companies.

Where any rule, regulation, order made by the Commission or any direction issued thereunder is contravened by a company, every person who, at the time the contravention was committed, was in charge, and was responsible to the company for conducting business of the company, as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished. However it will be a good defence by a person liable to any punishment if he proves that the contravention was committed without his knowledge or that he has exercised all due diligence to prevent the commission of an offence.

Where a contravention of any of the provisions of this Act or any rule, regulation, order made or direction issued thereunder has been committed by a company and it is proved that contravention has taken place with the consent or connivance of, or it is attributable to any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

The word company in this Section, has been used in a wider sense and also includes a 'firm' or an 'association of persons'. Though the word 'director' is normally used in a company, in the light of the wider definition, the term director is interpreted to include a partner of the firm. The company being a legal person, its affairs are conducted by a board of directors, manager, secretary or other officer, therefore, according to Section 48 (2) such director, manager, secretary or other officer, in addition to the company itself shall be deemed to be liable to be proceeded

against for contravention of any provisions of this Act or any rule, regulation, order made or direction issued thereunder by the Commission or the Director General of Investigation.

### Competition Advocacy

Under Section 49 the Central Government/State Government may seek the opinion of the CCI on the possible effects of the policy on competition or any other matter. In this context, Section 49 envisages that while formulating a policy on the competition, the Government may make a reference to the Commission for its opinion on possible effect of such a policy on the competition, or any other matter.

On receipt of such a reference, the Commission shall, give its opinion on it to the Central Government/State Government, within sixty days of making such a reference and the latter may formulate the policy as it deems fit. The role of the Commission is advisory and the opinion given by the Commission shall not be binding upon the Central Government/State Government in formulating such a policy. The Commission is also empowered to take suitable measures for the

- (a) promotion of competition advocacy;
- (b) creating awareness about the competition; and
- (c) imparting training about competition issues.

The creating awareness about benefits of competition and imparting training in competition issues is expected to generate conducive environment to promote and foster competition, which is sine-qua non for accelerating economic growth.

### FINANCE, ACCOUNTS AND AUDIT

#### Grants by Central Government

The Central Government may make to the Commission grants of such sums of money as it may think fit for being utilised for the purposes of the Act. Such grant is to be made after due appropriation made by the Parliament.

#### Constitution of Fund

The Act provides for the constitution of a fund called the "Competition Fund" for meeting the establishment and other expenses of the Competition Commission in connection with the discharge of its functions and for the purposes of this Act. The following shall be credited to the "Competition Fund", -

- (a) all government grants received by the commission;
- (b) Omitted
- (c) the fees received under the Act;
- (d) the interest on the amounts accrued on the monies referred under clauses (a) to (c). Fee realized alongwith notice disclosing combination shall form part of 'Competition Fund'.

The Fund shall be administered by a Committee of such Members of the Commission, as may be determined by the Chairperson and the Committee so appointed, shall spend monies out of the Fund only for the objects for which the Fund has been constituted.

#### Accounts and Audit

Proper accounts and other relevant records shall be maintained by the Commission and an annual statement of accounts shall be prepared by it in prescribed form in consultation with the Comptroller and Auditor General of India (CAG). The CAG shall specify the intervals within which the accounts of the Commission shall be audited by him.

Explanation to Section 52(2) clarifies that the orders passed by the Commission, being matters appealable to the Supreme Court, shall not be subject to audit by the CAG. The expenses, if any, incurred in connection with such audit shall be payable by the Commission to the CAG.

The CAG or any person appointed by him in connection with the audit of the accounts of the Commission shall have same rights, privileges and authority in connection with such audit as CAG has in connection with the audit of Government accounts and, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Commission.

Only accounts as certified by the CAG and any other person authorised by him in this behalf together with the audit report thereon shall be forwarded to the Central Government and the Government shall cause it to be laid before each House of Parliament.

### **Furnishing of Returns, etc., to Central Government**

The Commission shall furnish to the Central Government such returns and statements and such particulars in regard to any proposed or existing measures for promotion of competition advocacy, creating awareness and imparting training about competition issues, in such form and such manner as the Central Government may prescribe. An annual report giving a true and full account of activities of the Commission during the previous year shall be prepared once in every year by the Commission and submitted to the Central Government.

A copy of the annual report of the Commission received by the Government shall cause to be laid by the Central Government before each House of Parliament.

### **Appellate Tribunal**

According to Section 53A of the Act, the National Company Law Appellate Tribunal constituted under section 410 of the Companies Act, 2013 shall, on and from the commencement of Part XIV of Chapter VI of the Finance Act, 2017, be the Appellate Tribunal for the purposes of this Act and the said Appellate Tribunal shall—

- (a) hear and dispose of appeals against any direction issued or decision made or order passed by the Commission under sub-sections (2) and (6) of section 26, section 27, section 28, section 31, section 32, section 33, section 38, section 39, section 43, section 43A, section 44, section 45 or section 46 of this Act; and
- (b) adjudicate on claim for compensation that may arise from the findings of the Commission or the orders of the Appellate Tribunal in an appeal against any finding of the Commission or under section 42A or under sub-section (2) of section 53Q of this Act, and pass orders for the recovery of compensation under section 53N of this Act.

In *Competition Commission of India v. Steel Authority of India (Civil Appeal No. 7779 of 2010, judgment dated September 09, 2010)*, Supreme Court of India held that in terms of Section 53A(1)(a) of the Act appeal shall lie only against such directions, decisions or orders passed by the Commission before the Tribunal which have been specifically stated under the provisions of Section 53A(1)(a). The orders, which have not been specifically made appealable, cannot be treated appealable by implication. For example taking a *prima facie* view and issuing a direction to the Director General for investigation would not be an order appealable under Section 53A. Supreme Court noted that the principle of 'appeal being a statutory right and no party having a right to file appeal except in accordance with the prescribed procedure' is now well settled. Supreme Court observed that the expression 'any', in fact, qualifies each of the three expressions 'direction issued or decision made or order passed'. It cannot be said that it signifies any one of them and, particularly, only 'direction issued'. All these words have been used by the legislature consciously and with a purpose. It has provided for complete mechanism ensuring their implementation under the provisions of the Act, for example, under Section 26(1) the Commission is expected to make a decision by formation of a *prima facie* opinion and issue a direction to cause an investigation to be made by the Director General and after receiving the report has to take a final view in terms of Section 26(6) and even otherwise, it has the discretion to form an opinion and even close a case under Section 26(2). Having enacted these provisions, the legislature in its wisdom, made only the order under Section 26(2) and 26(6) appealable under Section 53A of the Act. Thus, it specifically excludes the opinion/decision of the authority under Section 26(1) and even an order passed under Section 26(7) directing further inquiry, from being appealable before the Tribunal. Therefore, it would neither be permissible nor advisable to make these provisions appealable against the legislative mandate. Accordingly, Supreme Court held that no appeal will lie from any decision, order or direction of the Commission which is not made specifically appealable under Section 53A(1)(a) of the Act.

## Appeal to Appellate Tribunal

Section 53B provides that the Central Government or the State Government or a local authority or enterprise or any person, aggrieved by any direction, decision or order referred to in clause (a) of section 53A may prefer an appeal to the Appellate Tribunal.

Every appeal shall be filed within a period of sixty days from the date on which a copy of the direction or decision or order made by the Commission is received by the Central Government or the State Government or a local authority or enterprise or any person and it shall be in such form and be accompanied by such fee as may be prescribed. Provided that the Appellate Tribunal may entertain an appeal after the expiry of the said period of sixty days if it is satisfied that there was sufficient cause for not filing it within that period.

On receipt of an appeal, the Appellate Tribunal may, after giving the parties to the appeal, an opportunity of being heard, pass such orders thereon as it thinks fit, confirming, modifying or setting aside the direction, decision or order appealed against.

The Appellate Tribunal shall send a copy of every order made by it to the Commission and the parties to the appeal.

(5) The appeal filed before the Appellate Tribunal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal within six months from the date of receipt of the appeal.

## Right to legal representation

A person preferring an appeal to the Appellate Tribunal may either appear in person or authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to present his or its case before the Appellate Tribunal.

The Central Government or a State Government or a local authority or any enterprise preferring an appeal to the Appellate Tribunal may authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

The Commission may authorize one or more chartered accountants or company secretaries or cost accountants or legal practitioners or any of its officers to act as presenting officers and every person so authorized may present the case with respect to any appeal before the Appellate Tribunal.

*Explanation* – The expressions “chartered accountant” or “company secretary” or “cost accountant” or “legal practitioner” shall have the meanings respectively assigned to them in the Explanation to section 35.

## Appeal to Supreme Court

The Central Government or any State Government or the Commission or any statutory authority or any local authority or any enterprise or any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to them. The Supreme court may, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the said period, allow it to be filed after the expiry of the said period of sixty days.

## Power to Punish for contempt

The Appellate Tribunal shall have, and exercise, the same jurisdiction, powers and authority in respect of contempt of itself as a High Court has and may exercise and, for this purpose, the provisions of the Contempt of Courts Act, 1971 shall have effect subject to modifications that,—

- the reference therein to a High Court shall be construed as including a reference to the Appellate Tribunal;
- the references to the Advocate-General in section 15 of the said Act shall be construed as a reference to such Law Officer as the Central Government may, by notification, specify in this behalf.

## MISCELLANEOUS

### Power to exempt

- (a) The Central Government may, by notification exempt from the application of the Act, or any provision thereof—
- (b) any class of enterprises if such exemption is necessary in the interest of security of the State or public interest;
- (c) any practice or agreement arising out of and in accordance with any obligation assumed by India under any treaty, agreement or convention with any other country or countries;
- (d) any enterprise, which performs a sovereign function on behalf of the Central Government or a State Government.

Thus, the power to grant exemption can be invoked by the Central Government in specified circumstances and conditions.

Where any enterprise is engaged in activities, which includes any activity relatable to the sovereign functions of the Government, exemption may be granted by the Central Government only in respect of the activity relatable to the sovereign functions.

### Power of Central Government to issue directions

The Central Government may give in writing to the Commission such directions on questions of policy, other than those relating to technical and administrative matters and the Commission shall be bound by such directions. The Commission shall be given an opportunity to express its views to the Central Government before any direction is given by the Government to the Commission. The decision of the Central Government as to whether the question is of one of policy or not, shall be final.

### Power of Central Government to supersede Commission

It is stipulated under section 56 of the Act that if at any time the Central Government is of the opinion, -

- (a) that the Commission, on account of circumstances beyond its control is unable to discharge the functions or perform the duties imposed on it by or under the provisions of the Act; or
- (b) that the commission has persistently made default in complying with any direction given by the Central Government under this Act or in discharge of functions or performance of duties imposed on it by or under the provisions of the Act and as a result of such default the financial position or the administration of the Commission has suffered; or
- (c) that the circumstances exist which render it necessary in the public interest to do so, the Central Government may, by notification and for the reasons stated therein, supersede the Commission for such period, not exceeding six months, as may be specified in the notification.

Thus, power to supersede CCI vests in the Central Government. However before issuing any such notification the Central Government shall give to the Commission a reasonable opportunity to make representations against the proposed supersession for its consideration. Upon publication of a notification superseding the Commission –

- (a) the Chairperson and other members shall vacate the office from the date of supersession;
- (b) until Commission is reconstituted, all powers functions and duties of the Commission shall be discharged by the Central Government or by an authority specified by the Central Government in this behalf;
- (c) until the Commission is reconstituted all of its properties shall vest in the Central Government.

The Central Government shall reconstitute the Commission by a fresh appointment of its Chairman and other Members on or before the expiration of six months from the date of order of the Central Government superseding the Commission. Any Chairperson or Member who vacates the office because the Commission is unable to discharge its functions or perform duties imposed on it by or under the provisions of this Act on account of circumstance beyond its control shall not be deemed to be disqualified for re-appointment upon re-constitution of the Commission by the Government.

The Central Government shall cause a notification superseding the Commission and a full report of any action taken under this Section and circumstances leading to such action, be laid before each House of the Parliament at the earliest.

### Restriction on disclosure of information

The Commission from time to time may require any enterprise to submit information for the purposes of the Act. The information may relate to sensitive business secrets and patents of such an enterprise. In order to ensure complete secrecy of such information, Section 57 provides that no information relating to any enterprise, being an information which has been obtained by or on behalf of the Commission or the Appellate Tribunal for the purposes of this Act, shall, without the previous permission in writing of the enterprise, be disclosed otherwise than in compliance with or for the purposes of this Act or any other law for the time being in force.

### Exclusion of jurisdiction of Civil Courts

A civil court is precluded to exercise jurisdiction in respect of any matter, which the Commission is empowered by or under the Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.

### Application of other laws not barred

The provisions of the Act are in addition to, and not in derogation of, the provisions of any other law for the time being in force.

## POWER TO MAKE RULES

The Central Government may, by notification, make rules to carry out provisions of this Act. In particular, the Central Government may make rules to provide for all or any of the following matters; namely-

- (a) the term of the Selection Committee and the manner of selection of panel of names under sub-section (2) of Section 9;
- (b) the form and manner in which and the authority before whom the oath of office and of secrecy shall be made and subscribed to under Sub-section (3) of Section 10;
- (c) Omitted by the Competition (Amendment) Act, 2007;
- (d) the salary and the other terms and conditions of service including travelling expenses, house rent allowance and conveyance facilities, sumptuary allowance and medical facilities to be provided to the Chairperson and other Members under Sub-section (1) of Section 14;
- (da) the number of Additional, Joint, Deputy or Assistant Director General or such officers or other employees in the office of DG and the manner in which such Additional, Joint, Deputy or Assistant Director Generals or such officers or other employees may be appointed under sub-section (1A) of Section 16.
- (e) the salary, allowances and other terms and conditions of service of the Director General, Additional, Joint, Deputy or Assistant Directors General or such officers or other employees under Sub-section (3) of Section 16;
- (f) the qualifications for appointment of the Director General, Additional, Joint, Deputy or Assistant Directors General or such officers or other employees under Sub-section (4) of Section 16;
- (g) the salaries and allowances and other terms and conditions of service of the Secretary and officers and other employees payable, and the number of such officers and employees under Sub-section (2) of Section 17;
- (h) for securing any case or matter which requires to be decided by a Bench composed of more than two Members under Sub-section (4) of Section 23; (Omitted by the Competition (Amendment) Act, 2007)
- (i) any other matter in respect of which the Commission shall have power under clause (g) of Sub-section (2) of Section 36; (Omitted by the Competition (Amendment) Act, 2007)
- (j) the promotion of competition advocacy, creating awareness and imparting training about competition issues under Sub-section (3) of Section 49; (Omitted by the Competition (Amendment) Act, 2007)

- (k) the form in which the annual statement of accounts shall be prepared under Sub-section (1) of Section 52;
- (l) the time within which and the form and manner in which the Commission may furnish returns, statements & such particulars as the Central Government may require under Sub-section (1) of Section 53;
- (m) the form in which and the time within which the annual report shall be prepared under Sub-section (2) of Section 53;
- (ma) the form in which an appeal may be filed before the Appellate Tribunal under sub-section (2) of section 53B and the fees payable in respect of such appeal;
- (mb) the term of the Selection Committee and the manner of selection of panel of names under sub-section(2) of section 53E;
- (mc) the salaries and allowances and other terms and conditions of service of the Chairperson and other Members of the Appellate Tribunal under sub-section (1) of section 53G;
- (md) the salaries and allowances and other conditions of service of the officers and other employees of the Appellate Tribunal under sub-section (3) of section 53M;
- (me) the fee which shall be accompanied with every application made under sub-section (2) of section 53N;
- (mf) the other matters under clause (i) of sub-section(2) of section 53O in respect of which the Appellate Tribunal shall have powers under the Code of Civil Procedure, 1908 (5 of 1908) while trying a suit;
- (n) the manner in which the monies transferred to the Central Government shall be dealt with by that Government under the fourth proviso to Sub-section (2) of Section 66;
- (o) any other matter which is to be, or may be, prescribed, or in respect of which provision is to be, or may be, made by rules.

Every notification for making such rules shall be laid before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session, or in two or more successive sessions. If both Houses agree that notification is not be issued or rule should not be made, then rule shall not be made or if the House decides that notification or rules should have effect in such modified form then the rule or notification shall be enforced in modified form. However, any such modification or annulment shall be without prejudice to the validity of anything previously done under the notification or rule, as the case may be.

### **POWER TO MAKE REGULATIONS**

The Commission may, by notification, make regulations, which are consistent with the Act. Without prejudice to the generality of the foregoing provision, such regulations may provide for all or any of the following matters, namely,

- (a) the cost of production to be determined under clause (b) of the Explanation to Section 4;
- (b) the form of notice as may be specified and the fee which may be determined under Sub-section (2) of Section 6;
- (c) the form in which details of acquisition shall be filed under Sub-section (5) of Section 6;
- (d) the procedure to be followed for engaging the experts and the professionals under sub-section (3) of Section 17;
- (e) the fee which may be determined under clause (a) of Sub-section (1) of Section 19;
- (f) the rules of procedure in regard to transaction of business at the meetings of the Commission under sub-section (1) of Section 22;
- (g) the manner in which penalty shall be recovered under sub-section (1) of Section 39;
- (h) any other matter in respect of which provision is to be, or may be made by regulations.

Every regulation shall be laid before both the Houses of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the regulation, or both Houses agree that the regulation should not be made, the regulation shall thereafter have effect only in such modified form or be of no effect, as the case may be. However, any such modification or annulment shall be without prejudice to the validity of anything previously done under that regulation.

## Power to remove difficulties

The Central government may, by order published in the Official Gazette, make such provisions, not inconsistent with the provisions of the Act as may appear to be necessary to remove difficulties which may arise in giving effect to the provisions of the Act. However, no such order shall be made after expiry of a period of two years from the commencement of the Act. Every order made under this Section shall be laid before both the Houses of Parliament as soon as may be, after it is made.

## Important Case Laws

**Scope of filing of Information before Competition Commission of India [Section 19] and filing of Appeal before National Company Law Appellate Tribunal [Section 53B], Supreme Court of India [Section 53T] etc.**

In *Samir Agrawal Vs Competition Commission of India* (Civil Appeal No. 3100 of 2020, judgment dated December 15, 2020), Hon'ble Supreme Court of India setting aside judgment of National Company Law Appellate Tribunal [NCLAT] looked into following issues viz. whether "information" may be received by the Competition Commission of India [CCI] from any person, whether such person is or is not personally affected; and whether a person like the Informant can be said to be a "person aggrieved" for the purpose of sections 53B and 53T of the Competition Act, 2002 ["the Act"]. Accordingly, while deciding the said issues, Hon'ble Supreme Court of India laid down law relating to issue of "locus standi" with reference to section 19 of the Act; and "person aggrieved" for the purposes of filing appeal before NCLAT and Supreme Court respectively.

### "any person" may provide information to the CCI

Hon'ble Supreme Court after looking into the scheme of the Act and Competition Commission of India (General) Regulations, 2009 ["2009 Regulations"] observed that reading of the provisions of the Act and the 2009 Regulations would show that "any person" may provide information to the CCI, which may then act upon it in accordance with the provisions of the Act. In this regard, the definition of "person" in section 2(l) of the Act, set out hereinabove, is an inclusive one and is extremely wide, including individuals of all kinds and every artificial juridical person. This may be contrasted with the definition of "consumer" in section 2(f) of the Act, which makes it clear that only persons who buy goods for consideration, or hire or avail of services for a consideration, are recognised as consumers. Supreme Court observed that look at section 19(1) of the Act would show that the Act originally provided for the "receipt of a complaint" from any person, consumer or their association, or trade association. This expression was then substituted with the expression "receipt of any information in such manner and" by the 2007 Amendment. This substitution is not without significance. Whereas, a *complaint* could be filed only from a person who was aggrieved by a particular action, *information* may be received from any person, obviously whether such person is or is not personally affected. This is for the reason that the proceedings under the Act are proceedings *in rem* which affect the public interest. Hon'ble Supreme Court of India further observed that the CCI may inquire into any alleged contravention of the provisions of the Act on its own motion, is also laid down in section 19(1) of the Act. Further, even while exercising *suo motu* powers, the CCI may receive information from any person and not merely from a person who is aggrieved by the conduct that is alleged to have occurred. This also follows from a reading of section 35 of the Act, in which the earlier expression "complainant or defendant" has been substituted by the expression, "person or an enterprise," setting out that the informant may appear either in person, or through one or more agents, before the CCI to present the information that he has gathered. Supreme Court of India noted that Section 45 of the Act is a deterrent against persons who provide information to the CCI, *mala fide* or recklessly, inasmuch as false statements and omissions of material facts are punishable with a penalty which may extend to the hefty amount of rupees one crore, with the CCI being empowered to pass other such orders as it deems fit. This, and the judicious use of heavy costs being imposed when the information supplied is either frivolous or *mala fide*, can keep in check what is described as the growing tendency of persons being "set up" by rivals in the trade. Supreme Court of India noted that the 2009 Regulations also point in the same direction inasmuch as regulation 10, does not require the informant to state how he is personally aggrieved by the contravention of the Act, but only requires a statement of facts and details of the alleged contravention to be set out in the information filed. Also, regulation 25 shows that public interest must be foremost in the consideration of the CCI when an application is made to it in writing that a person or enterprise has substantial interest in the outcome of the proceedings, and such person may therefore be allowed to take part in the proceedings. What is also extremely important is regulation 35, by which

the CCI must maintain confidentiality of the identity of an informant on a request made to it in writing, so that such informant be free from harassment by persons involved in contravening the Act.

### **“person aggrieved” for the purpose of sections 53B and 53T of the Act**

As regards whether a person like the Informant can be said to be a “person aggrieved” for the purpose of sections 53B and 53T of the Act, Hon’ble Supreme Court observed that given the context of the Act in which the CCI and the NCLAT deal with practices which have an adverse effect on vests powers in the CCI and enables it to act *in rem*, in public interest. This would make it clear that a “person aggrieved” must, in the context of the Act, be understood widely. Further, it is not without significance that the expressions used in sections 53B and 53T of the Act are “any person”, thereby signifying that *all* persons who bring to the CCI information of practices that are contrary to the provisions of the Act, could be said to be aggrieved by an adverse order of the CCI in case it refuses to act upon the information supplied. By way of contrast, section 53N(3) speaks of making payment to an applicant as compensation for the loss or damage caused to the applicant as a result of any contravention of the provisions of Chapter II of the Act, having been committed by an enterprise. By this sub-section, clearly, therefore, “any person” who makes an application for compensation, under sub-section (1) of section 53N of the Act, would refer only to persons who have suffered loss or damage, thereby, qualifying the expression “any person” as being a person who has suffered loss or damage. Obviously, when the CCI performs inquisitorial, as opposed to adjudicatory functions, the doors of approaching the CCI and the appellate authority, i.e., the NCLAT, must be kept wide open in public interest, so as to subserve the high public purpose of the Act.

### ***Ambit and scope of power vested with the Commission under Section 26(1) of the Competition Act, 2002***

In *Competition Commission of India v. Steel Authority of India (Civil Appeal No. 7779 of 2010, judgment dated September 09, 2010)*, looked into the ambit and scope of power vested with the Commission under Section 26(1) of the Act and whether the parties, including the informant or the affected party, are entitled to notice or hearing, as a matter of right, at the preliminary stage of formulating an opinion as to the existence of the *prima facie* case. With regard to notice and/or hearing at the stage of forming *prima facie* decision by the Commission under Section 26 (1) of the Act, Supreme Court of India held that neither any statutory duty is cast on the Commission to issue notice or grant hearing, nor any party can claim, as a matter of right, notice and/or hearing at the stage of formation of opinion by the Commission, in terms of Section 26(1) of the Act that a *prima facie* case exists for issuance of a direction to the Director General to cause an investigation to be made into the matter. However, the Commission, being a statutory body exercising, *inter alia*, regulatory jurisdiction, even at that stage, in its discretion and in appropriate cases may call upon the concerned party(s) to render required assistance or produce requisite information, as per its directive. Supreme Court also observed that the Commission is expected to form such *prima facie* view without entering upon any adjudicatory or determinative process. The Commission is entitled to form its opinion without any assistance from any quarter or even with assistance of experts or others. The Commission has the power in terms of Regulation 17 (2) of the Regulations to invite not only the information provider but even ‘such other person’ which would include all persons, even the affected parties, as it may deem necessary. In that event it shall be ‘preliminary conference’, for whose conduct of business the Commission is entitled to evolve its own procedure.

In the aforesaid context, Supreme Court noted kind of function the Commission is called upon to discharge while forming an opinion under Section 26(1) of the Act. Supreme court observed that at the face of it, this is an inquisitorial and regulatory power. The jurisdiction of the Commission, to act under this provision, does not contemplate any adjudicatory function. The Commission is not expected to give notice to the parties, i.e. the informant or the affected parties and hear them at length, before forming its opinion. The function is of a very preliminary nature and in fact, in common parlance, it is a departmental function. At that stage, it does not condemn any person and therefore, application of *audi alteram partem* is not called for. Formation of a *prima facie* opinion departmentally (Director General, being appointed by the Central Government to assist the Commission, is one of the wings of the Commission itself) does not amount to an adjudicatory function but is merely of administrative nature. At best, it can direct the investigation to be conducted and report to be submitted to the Commission itself or close the case in terms of Section 26(2) of the Act, which order itself is appealable before the Tribunal and only after this stage, there is a specific right of notice and hearing available to the aggrieved/affected party. Accordingly, keeping in mind the nature of the functions required to be performed by the Commission in terms of Section 26(1), Supreme Court observed that the right of notice of hearing is not contemplated under the provisions of Section 26(1) of the Act.

Supreme Court also looked into the issue whether it is obligatory for the Commission to record reasons for formation of a *prima facie* opinion in terms of Section 26(1) of the Act. Supreme Court held that in consonance with the settled principles of administrative jurisprudence, the Commission is expected to record at least some reason even while forming a *prima facie* view. However, while passing directions and orders dealing with the rights of the parties in its adjudicatory and determinative capacity, it is required of the Commission to pass speaking orders, upon due application of mind, responding to all the contentions raised before it by the rival parties.

In the aforesaid context, Supreme Court of India noted that the proposition of law whether an administrative or quasi judicial body, particularly judicial courts, should record reasons in support of their decisions or orders is no more *res integra* and has been settled by a recent judgment of this Court in the case of Assistant Commissioner, C.T.D.W.C. v. M/s Shukla & Brothers [JT 2010 (4) SC 35]. Reasons are the links between the materials on which certain conclusions are based and the actual conclusions. By practice adopted in all courts and by virtue of judge made law, the concept of reasoned judgment has become an indispensable part of basic rule of law and in fact, is a mandatory requirement of the procedural law. Supreme Court noted that recording reasons in support of decisions or orders is consistent with the settled canons of law and would apply to Section 26, under its different sub-sections, which requires the Commission to issue various directions, take decisions and pass orders, some of which are even appealable before the Tribunal. Supreme Court also noted that even if it is a direction under any of the provisions and not a decision, conclusion or order passed on merits by the Commission, it is expected that the same would be supported by some reasoning. At the stage of forming a *prima facie* view, as required under Section 26(1) of the Act, the Commission may not really record detailed reasons, but must express its mind in no uncertain terms that it is of the view that *prima facie* case exists, requiring issuance of direction for investigation to the Director General. Such view should be recorded with reference to the information furnished to the Commission. Such opinion should be formed on the basis of the records, including the information furnished and reference made to the Commission under the various provisions of the Act, as afore-referred. However, other decisions and orders, which are not directions *simpliciter* and determining the rights of the parties, should be well reasoned analyzing and deciding the rival contentions raised before the Commission by the parties. In other words, the Commission is expected to express *prima facie* view in terms of Section 26(1) of the Act, without entering into any adjudicatory or determinative process and by recording minimum reasons substantiating the formation of such opinion, while all its other orders and decisions should be well reasoned.

### ***Competition Commission of India: Necessary or Proper Party before Appellate Tribunal***

In *Competition Commission of India v. Steel Authority of India (Civil Appeal No. 7779 of 2010, judgment dated September 09, 2010)*, Supreme Court noted that the concept of necessary and proper parties is an accepted norm of civil law and its principles can safely be applied to the proceedings before the Tribunal to a limited extent. Supreme Court observed that the Commission, in cases where the inquiry has been initiated by the Commission *suo moto*, shall be a necessary party and in all other cases the Commission shall be a proper party in the proceedings before the Competition Tribunal. The presence of the Commission before the Tribunal would help in complete adjudication and effective and expeditious disposal of matters. Being an expert body, its views would be of appropriate assistance to the Tribunal. Thus, the Commission in the proceedings before the Tribunal would be a necessary or a proper party, as the case may be.

### ***Ambit and scope of the powers vested in the Competition Commission of India under section 33 of the Competition Act, 2002***

In *Competition Commission of India v. Steel Authority of India (Civil Appeal No. 7779 of 2010, judgment dated September 09, 2010)*, Supreme Court observed that during an inquiry and where the Commission is satisfied that the act is in contravention of the provisions stated in Section 33 of the Act, it may issue an order temporarily restraining the party from carrying on such act, until the conclusion of such inquiry or until further orders without giving notice to such party, where it deems it necessary. This power has to be exercised by the Commission sparingly and under compelling and exceptional circumstances. The Commission, while recording a reasoned order *inter alia* should : (a) record its satisfaction (which has to be of much higher degree than formation of a *prima facie* view under Section 26(1) of the Act) in clear terms that an act in contravention of the stated provisions has been committed and continues to be committed or is about to be committed; (b) It is necessary to issue order of restraint and (c) from the record before the Commission, it is apparent that there is every likelihood of the party to the *lis*, suffering irreparable and irretrievable damage or there is definite apprehension that it would have adverse effect

on competition in the market. Supreme Court concluded that the Commission can pass *ex parte ad interim* restraint orders in terms of Section 33, only after having applied its mind as to the existence of a *prima facie* case and issue direction to the Director General for conducting an investigation in terms of Section 26(1) of the Act. It has the power to pass *ad interim ex parte* injunction orders, but only upon recording its due satisfaction as well as its view that the Commission deemed it necessary not to give a notice to the other side. In all cases where *ad interim ex parte* injunction is issued, the Commission must ensure that it makes the notice returnable within a very short duration so that there is no abuse of the process of law and the very purpose of the Act is not defeated.

### ***Scheme relating to section 3 relating to anti-competitive agreements read with section 19 (3) of the Competition Act, 2002***

*In Rajasthan Cylinders and Containers Ltd v Union of India (Civil Appeal No. 3546 of 2014, judgment dated October 01, 2018)*, Supreme Court of India laid down the scheme relating to section 3 relating to anti-competitive agreements read with section 19 (3) relating to factors to be taken into account by the CCI while determining whether an agreement has an appreciable adverse effect on competition under section 3. Supreme Court observed that that Section 19(3) of the Act mentions the factors which are to be examined by the CCI while determining whether an agreement has an appreciable adverse effect on competition under Section 3. However, this inquiry would be needed in those cases which are not covered by clauses (a) to (d) of sub-section (3) of Section 3. Supreme Court observed that the agreements of nature mentioned in sub-section (3) are presumed to have an appreciable effect and, therefore, no further exercise is needed by the CCI once a finding is arrived at that a particular agreement fell in any of the aforesaid four categories. However, agreements mentioned in Section 3(3) raise a presumption that such agreements shall have an appreciable adverse effect on competition. It follows, as a *fortiori*, that the presumption is rebuttable as these agreements are not treated as conclusive proof of the fact that it would result in appreciable adverse effect on competition. What follows is that once the CCI finds that case is covered by one or more of the clauses mentioned in sub-section (3) of Section 3, it need not undertake any further enquiry and burden would shift upon such enterprises or persons etc. to rebut the said presumption by leading adequate evidence. In case such an evidence is led, which dispels the presumption, then the CCI shall take into consideration the factors mentioned in Section 19 of the Act and to see as to whether all or any of these factors are established. If the evidence collected by the CCI leads to one or more or all factors mentioned in Section 19(3), it would again be treated as an agreement which may cause or is likely to cause an appreciable adverse effect of competition, thereby compelling the CCI to take further remedial action in this behalf as provided under the Act.

### ***Standard of Proof in Cartels/ Collusive Bid Rigging cases***

*In Rajasthan Cylinders and Containers Ltd v Union of India (Civil Appeal No. 3546 of 2014, judgment dated October 01, 2018)*, Supreme Court of India observed that there may not be a direct evidence on the basis of which cartelisation or such agreement between the parties can be proved. As these agreements are normally entered into in closed doors. The standard of proof which is required is one of probability. Supreme Court also noted that even in the absence of proof of concluded formal agreement, when there are indicators that there was practical cooperation between the parties which knowingly substitute the risk of competition, that would amount to anti-competitive practices.

### ***Collusive bidding and Bid Rigging***

*In Rajasthan Cylinders and Containers Ltd v Union of India (Civil Appeal No. 3546 of 2014, judgment dated October 01, 2018)*, Supreme Court of India observed that though the expression 'collusive bidding' is not defined in the Act, it appears that both 'bid rigging' and 'collusive bidding' are overlapping concepts. This position stands accepted in *Excel Crop Care Ltd v Competition Commission of India* case wherein Supreme Court noted that no doubt, clause (d) of sub-section (3) of Section 3 uses both the expressions "bid rigging" and "collusive bidding", but the Explanation thereto refers to "bid rigging" only. However, it cannot be said that the intention was to exclude "collusive bidding". Even if the Explanation does contain the expression "collusive bidding" specifically, while interpreting clause (d), it can be inferred that "collusive bidding" relates to the process of bidding as well. Accordingly, Supreme Court in *Excel Corp Care Limited* Case observed that 'two expressions are to be interpreted using the principle of *noscitur a sociis* i.e. when two or more words which are susceptible to analogous meanings are coupled together, the words can take colour from each other.'

### **Test for parallel behaviour in bid rigging/ collusive bidding or tendering cases**

*In Rajasthan Cylinders and Containers Ltd v Union of India (Civil Appeal No. 3546 of 2014, judgment dated October 01, 2018)*, Supreme Court of India observed that the parameters on the basis of which collusive tendering are to be judged are stated in *Excel Crop Care Ltd v Competition Commission of India case*.

*In the Excel Crop Care Ltd case, Supreme Court observed that* existence of a concerted practice could be appraised correctly by keeping in mind the following test 'If the evidence upon which the contested decision is based is considered, not in isolation, but as a whole, account being taken of the specific features of the products in question.'

In the said *Excel Crop Care Ltd case*, Supreme Court also noticed that in an oligopoly situation, parallel behaviour may not, by itself, amount to a concerted practice by relying on observations made by European Court of Justice in Dyestuffs case [*Imperial Chemical Industries Ltd. v. Commission of European Communities*, 1972 ECR 619 (ECJ)] wherein it was observed that 'By its very nature, then, the concerted practice does not have all the elements of a contract but may inter alia arise out of coordination which becomes apparent from the behaviour of the participants. Although parallel behaviour may not itself be identified with a concerted practice, it may however amount to strong evidence of such a practice if it leads to conditions of competition which do not respond to the normal conditions of the market, having regard to the nature of the products, the size and number of the undertakings, and the volume of the said market. Such is the case especially where the parallel behaviour is such as to permit the parties to seek price equilibrium at a different level from that which would have resulted from competition, and to crystallise the status quo to the detriment of effective freedom of movement of the products in the [internal] market and free choice by consumers of their suppliers.'

Taking into account aforesaid principles, Supreme Court also dealt with the argument on oligopsony raised by the appellants that the market conditions lead to the situation of oligopsony that prevailed because of limited buyers and influence of buyers in the fixation of prices was all prevalent. In this regard, Supreme Court described the concept of monopsony by stating that monopsony consists of a market with a single buyer. Supreme Court stated that when there are only few buyers the market is described as an oligopsony. In this regard, Supreme Court emphasised that in such a situation a manufacturer with no buyers will have to exit from the trade. Supreme Court noted that the situation of oligopsony can be both ways. There may be a situation where the sellers are few and they may control the market and by their concerted action indulge into cartelization. It may also be, as in the present case, a situation where buyers are few and that results in the situation of oligopsony with the control of buyers. Supreme Court noted that as per CCI there was a collusive tendering, which is inferred from the parallel behaviour of the appellants, namely, quoting almost the same rates in their bids. On a holistic view of the matter, Supreme Court observed that the appellants have been able to discharge the onus by referring to various indicators which go on to show that parallel behaviour was not the result of any concerted practice. In Dyestuffs, the European Court held that parallel behaviour does not, by itself, amount to a concerted practice, though it may provide a strong evidence of such a practice. Nevertheless, it is a strong evidence of such a practice. However, before such an inference is drawn it has to be seen that this parallel behaviour has led to conditions of competition which do not correspond to the normal conditions of the market, having regard to the nature of the products, size and volume of the undertaking of the said market.

Accordingly, examining the matter from the stand point of market economy where question of oligopsony assumes relevance, Supreme Court observed that whenever there is a situation of oligopsony, parallel pricing simplicitor would not lead to the conclusion that there was a concerted practice. There has to be other credible and corroborative evidence to show that in an oligopoly a reduction in price would swiftly attract the customers of the other two or three rivals, the effect upon whom would be so devastating that they would have to react by matching the cut.

On facts, Supreme Court of India after taking note of the test that needs to be applied in such cases, which was laid down in Dyestuffs and accepted in *Excel Crop Care Limited case* concluded that the inferences drawn by the CCI on the basis of evidence collected by it are duly rebutted by the appellants and the appellants have been able to discharge the onus that shifted upon them on the basis of factors pointed out by the CCI.

### LESSON ROUND-UP

- Competition Act, 2002 seeks to provide, keeping in view the economic development of the country, for the establishment of Competition Commission to prevent practices having adverse effect on competition, to promote and sustain competition in markets, to protect the interests of consumers and to ensure freedom of trade carried on by other participants in markets in India and for matters connected therewith or incidental thereto besides repeal of MRTP Act and the dissolution of the MRTP Commission.
- No enterprise or association of enterprises or person or association of persons shall enter into any agreement in respect of production, supply, distribution, storage, acquisition or control of goods or provision of services, which causes or is likely to cause an appreciable adverse effect on competition.
- Competition Act expressly prohibits any enterprise or group from abusing its dominant position. Dominant Position meaning thereby a position of strength, enjoyed by an enterprise or group, in the relevant market, in India, which enables it to operate independently of competitive forces prevailing in the relevant market; or affect its competitors or consumers or the relevant market in its favour.
- Competition Act prohibits any person or enterprise from entering into a combination which causes or is likely to cause an appreciable adverse effect on competition within the relevant market in India and if such a combination is formed it shall be void.
- While formulating a policy on the competition the Central/State Government may make a reference to the Commission for its opinion on possible effect of such a policy on the competition.
- Competition Appellate Tribunal to hear and dispose of appeals against the direction issued or decision made or orders passed by the Commission under the Act, and to adjudicate on claim of compensation.
- The Central Government or any State Government or the Commission or any statutory authority or any local authority or any enterprise or any person aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the Supreme Court.

### TEST YOURSELF

*(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation)*

1. (These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)
1. Define and discuss the Relevant Market, Relevant Geographic Market, and Relevant Product Market.
2. What are anti-competitive agreements? Discuss the procedure for enquiry into anti-competitive agreements.
3. The Competition Act does not prohibit dominance, but the abuse of dominant position. Explain.
4. Discuss the composition and functions of Competition Commission of India.
5. Write short notes on:
  - (i) Combinations.
  - (ii) Competition Advocacy.



# Consumer Protection Act, 2019

## Lesson 13

### ***Key Concepts One Should Know***

- Consumer Rights
- Consumer
- Commercial Purpose
- E-Commerce
- Electronic Service Provider
- Express Warranty
- Misleading Advertisement
- Product Liability
- Restrictive Trade Practice

### ***Learning Objectives***

#### **To understand:**

- Consumer Protection in India
- Rights of Consumers
- Consumer Dispute Redressal Forums
- Central Consumer Protection Authority
- Nature and Scope of Remedies
- Consumer Disputes Redressal Commission

### ***Regulatory Framework***

- Consumer Protection Act, 2019
- Consumer Protection (Consumer Disputes Redressal Commissions) Rules, 2020
- Consumer Protection (General) Rules, 2020
- Consumer Protection (Central Consumer Protection Council) Rules, 2020
- Consumer Protection (E-Commerce) Rules, 2020
- Consumer Protection (Consumer Commission Procedure) Regulations, 2020
- Central Consumer Protection Authority (Allocation and Transaction of Business) Regulations, 2020.

### ***Lesson Outline***

- Consumer Rights
- Meaning of Consumer
- Commercial purpose
- Defect in Goods
- Deficiency in Service
- Contract of Service
- Contract for Service
- District Forum
- State Consumer Protection Council
- Central Consumer Protection Council
- Jurisdiction of Protection Council
- Limitation Period for Filing Complaint
- Administrative Control
- Appeal
- Nature and Scope of Remedies
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

A consumer is a user of goods and services, therefore, every producer is also a consumer. However, conflicting interests have categorised them, inevitably, into two different groups. The industrial revolution brought in the concept of standardisation and mass production and over the years, the type of goods and the nature of services available grew manifold. The doctrine of 'Caveat Emptor' or 'let the buyer beware' which came into existence in the middle ages had been replaced by the principle of 'Consumer Sovereignty' or 'Consumer is the King'. But, with tremendous increase in the world population, the growing markets were unable to meet the rising demand which created a gap between the general 'demand' and 'supply' levels in the markets. This to some extent watered down the concept of 'Consumer Sovereignty', what with consumers being forced to accept whatever was offered to them. On the other hand, the expanding markets necessitated the introduction of various intermediaries between the producer and the ultimate consumer. 'Advertising', though ostensibly directed at informing potential consumers about the availability and uses of a product began to be resorted to as a medium for exaggerating the uses of ones products or disparaging others products so as to have an edge over competitors. Unfair and deceptive practices such as selling of defective or sub-standard goods, charging exorbitant prices, misrepresenting the efficacy or usefulness of goods, negligence as to safety standards, etc. became rampant. It, therefore, became necessary to evolve statutory measures, even in developed countries, to make producers/traders more accountable to consumers. It also became inevitable for consumers to unite on a common platform to deal with issues of common concern and having their grievances redressed satisfactorily.

Consumer justice is a part of social and economic justice enshrined in the Constitution. India has been a pioneer in consumer advocacy with the Consumer Protection Act, 1986, enacted in 1986, a path breaking socio economic legislation and most important milestones in the area of consumer movement in India. The Act provides the legislative framework to promote and protect the rights of consumers and a three-tier quasi-judicial consumer disputes redressal machinery at the District, State and National levels, popularly known as Consumer Courts aimed at providing simple, speedy and affordable redress to consumers. The consumer courts adjudicate complaints relating to defects in goods and deficiencies in services and are meant to provide simple, inexpensive and speedy redressal of consumers' grievances. The Consumer Protection Act, 1986 also provides for establishment of Consumer Protection Councils at the Central, State and District levels to function as Advisory Bodies on consumer advocacy. Based on the experience gained from implementation on the ground, the Act has been amended thrice in the years 1991, 1993 and 2002. Although, the working of the consumer dispute redressal agencies has served the purpose to a considerable extent, the disposal of cases has not been fast due to various constraints. Several shortcomings have been noticed while administering the various provisions of the Consumer Protection Act, 1986.

Consumer markets for goods and services have undergone drastic transformation since the enactment of the Consumer Protection Act in 1986. The modern market place contains a plethora of products and services. The emergence of global supply chains, rise in international trade and the rapid development of e-commerce have led to new delivery systems for goods and services and have provided new options and opportunities for consumers. Equally, this has rendered the consumer vulnerable to new forms of unfair trade and unethical business practices. Misleading advertisements, tele-marketing, multi-level marketing, direct selling and e-commerce pose new challenges to consumer protection and will require appropriate and swift executive interventions to prevent consumer detriment and to counter unfair trade practices. Therefore, it has become inevitable to modernise the Consumer Protection Act in 1986 to address the myriad and constantly emerging vulnerabilities of the consumer in the market economy extant.

In this backdrop, the Consumer Protection Bill, 2019 was passed by the Lok Sabha on 30th July, 2019 and by Rajya Sabha on 06th August, 2019 respectively. The Consumer Protection Act, 2019 received the assent of the President on the 9th August, 2019. The Consumer Protection Act, 2019 replaced the more than three decades old Consumer Protection Act, 1986.

Preamble of the Consumer Protection Act, 2019 provides for protection of the interests of consumers and for the said purpose, to establish authorities for timely and effective administration and settlement of consumers' disputes and for matters connected therewith or incidental thereto.

In the case of *Om Prakash vs. Reliance General Insurance and Anr. Civil Appeal No. 15611 OF 2017, (Arising out of SLP (C) No.742 of 2015)* Judgement dated October 4, 2017 Civil Appellate Jurisdiction of the Hon'ble Supreme Court of India inter-alia observed that it needs no emphasis that the Consumer Protection Act aims at providing better protection of the interest of consumers. It is a beneficial legislation that deserves liberal construction. This laudable object should not be forgotten while considering the claims made under the Act.

In the case of *M/S Emaar Mgf Land Limited vs Aftab Singh Review Petition (C) Nos. 2629-2630 of 2018 in Civil Appeal Nos. 23512-23513 of 2017 Civil Appellate Jurisdiction, Judgement dated 10 December, 2018* the Hon'ble Supreme Court of India held that the Consumer Protection Act, 1986 has been enacted to provide for better protection of the interests of consumers and for the purpose, to make provision for the establishment of Consumer Councils and other authorities for the settlement of consumer disputes and for matter connected therewith. This Court had occasion to consider the object and purpose of the Act in *Lucknow Development Act vs. M.K. Gupta, (1994) 1 SCC 243*, this Court elaborately noticed the object and purpose of the Act in the following words:

'To begin with the preamble of the Act, which can afford useful assistance to ascertain the legislative intention, it was enacted, to provide for the protection of the interest of consumers. Use of the word protection furnishes key to the minds of makers of the Act. Various definitions and provisions which elaborately attempt to achieve this objective have to be construed in this light without departing from the settled view that a preamble cannot control otherwise plain meaning of a provision. In fact the law meets long felt necessity of protecting the common man from such wrongs for which the remedy under ordinary law for various reasons has become illusory. Various legislations and regulations permitting the State to intervene and protect interest of the consumers have become a haven for unscrupulous ones as the enforcement machinery either does not move or it moves ineffectively, inefficiently and for reasons which are not necessary to be stated. The importance of the Act lies in promoting welfare of the society by enabling the consumer to participate directly in the market economy. It attempts to remove the helplessness of a consumer which he faces against powerful business, described as, a network of rackets or a society in which, producers have secured power to rob the rest and the might of public bodies which are degenerating into storehouses of inaction where papers do not move from one desk to another as a matter of duty and responsibility but for extraneous consideration leaving the common man helpless, bewildered and shocked. The malady is becoming so rampant, widespread and deep that the society instead of bothering, complaining and fighting against it, is accepting it as part of life. The enactment in these unbelievable yet harsh realities appears to be a silver lining, which may in course of time succeed in checking the rot".

### Main Features of Consumer Protection Act 2019

- E-commerce
- Direct selling
- Establishment of Central Consumer Protection Authority (CCPA)
- Strict Norms for Misleading Advertisement
- Strict Norms for product liability
- Pecuniary Jurisdiction
- Unfair Trade Practice
- Unfair Contract
- Alternate Dispute Resolution through mediation

## DEFINITIONS

### "Advertisement"

Advertisement means any audio or visual publicity, representation, endorsement or pronouncement made by means of light, sound, smoke, gas, print, electronic media, internet or website and includes any notice, circular, label, wrapper, invoice or such other documents. [Section 2(1)]

## **"Appropriate Laboratory"**

Appropriate Laboratory means a laboratory or an organisation-

- (i) Recognised by the Central Government; or
- (ii) recognised by a State Government, subject to such guidelines as may be issued by the Central Government in this behalf; or
- (iii) Established by or under any law for the time being in force, which is maintained, financed or aided by the Central Government or a State Government for carrying out analysis or test of any goods with a view to determining whether such goods suffer from any defect. [Section 2(2)]

## **"Branch Office"**

Branch office means-

- (i) any office or place of work described as a branch by the establishment; or
- (ii) any establishment carrying on either the same or substantially the same activity carried on by the head office of the establishment. [Section 2(3)]

## **"Central Authority"**

Central Authority means the Central Consumer Protection Authority established under section 10. [Section 2(4)]

## **"Complainant"**

Complainant means-

- (i) a consumer; or
- (ii) any voluntary consumer association registered under any law for the time being in force; or
- (iii) the Central Government or any State Government; or
- (iv) the Central Authority; or
- (v) one or more consumers, where there are numerous consumers having the same interest; or
- (vi) in case of death of a consumer, his legal heir or legal representative; or
- (vii) in case of a consumer being a minor, his parent or legal guardian. [Section 2(5)]

## **"Complaint"**

Complaint means any allegation in writing, made by a complainant for obtaining any relief provided by or under this Act, that-

- (i) an unfair contract or unfair trade practice or a restrictive trade practice has been adopted by any trader or service provider;
- (ii) the goods bought by him or agreed to be bought by him suffer from one or more defects;
- (iii) the services hired or availed of or agreed to be hired or availed of by him suffer from any deficiency;
- (iv) a trader or a service provider, as the case may be, has charged for the goods or for the services mentioned in the complaint, a price in excess of the price-
  - (a) fixed by or under any law for the time being in force; or
  - (b) displayed on the goods or any package containing such goods; or
  - (c) displayed on the price list exhibited by him by or under any law for the time being in force; or (d) agreed between the parties;
- (v) the goods, which are hazardous to life and safety when used, are being offered for sale to the public-

- (a) in contravention of standards relating to safety of such goods as required to be complied with, by or under any law for the time being in force;
- (b) where the trader knows that the goods so offered are unsafe to the public;
- (vi) the services which are hazardous or likely to be hazardous to life and safety of the public when used, are being offered by a person who provides any service and who knows it to be injurious to life and safety;
- (vii) a claim for product liability action lies against the product manufacturer, product seller or product service provider, as the case may be. [Section 2(6)]

### **"Consumer"**

Consumer means any person who-

- (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or
- (ii) hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such service other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person, but does not include a person who avails of such service for any commercial purpose.

Explanation.-For the purposes of this clause,-

- a. the expression "commercial purpose" does not include use by a person of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment;
- b. the expressions "buys any goods" and "hires or avails any services" includes offline or online transactions through electronic means or by teleshopping or direct selling or multi-level marketing. [Section 2(7)]

A purchase of goods can be said to be for a 'commercial purpose' only if the goods have been purchased for being used in some profit making activity on a large-scale, and there is close and direct nexus between the purchase of goods and the profit-making activity. In *Laxmi Engineering Works v. P.S.G. Industrial Institute*, Supreme Court held that the explanation to Section 2(1)(d) is clarificatory in nature. It observed that whether the purpose for which a person has bought goods is a 'commercial purpose' is always a question of facts and to be decided in the facts and circumstances of each case. If the commercial use is by the purchaser himself for the purpose of earning his livelihood by means of self-employment such purchaser of goods would yet be a consumer. The Supreme Court further observed that if a person purchased a machine to operate it himself for earning his livelihood, he would be a consumer. If such person took the assistance of one or two persons to assist him in operating the machine, he would still be a consumer. But if a person purchases a machine and appoint or engage another person exclusively to operate the machine, then such person would not be a consumer.

In *Bhupendra Jang Bahadur Guna vs. Regional Manager and Others* (II 1995 CPJ 139), the National Commission held that a tractor purchased primarily to till the land of the purchaser and let out on hire during the idle time to till the lands of others would not amount to commercial use.

The question as to whether the widow of the deceased policy holder was a 'consumer' under the Act was decided in the affirmative by the State Commission in Andhra Pradesh in the case of *A Narasamma vs. LIC of India*. The State Commission held that as the term 'consumer' includes any beneficiary of service other than the person who hires the services for consideration, the widow being the beneficiary of services is a 'consumer' under the Act entitled to be compensated for the loss suffered by her due to negligence of the LIC.

In *Laxmiben Laxmichand Shah v. Sakerben Kanji Chandan and others* 2001 CTJ 401 (Supreme Court) (CP), the Supreme Court held that the tenant entering into lease agreement with the landlord cannot be considered as consumer under Section 2(1)(d) of the Act. Where there was no provision in the lease agreement in respect of cleaning, repairing and maintaining the building, the rent paid by tenant is not the consideration for availing these services and therefore, no question of deficiency in service.

**Goods**, in terms of Section 2(1)(i) has been defined to mean goods as defined in the Sale of Goods Act, 1930. As per Section 2(7) of the Sale of Goods Act, 1930 Goods means every kind of movable property other than actionable claims and money; and includes stock and shares, growing crops, grass and things attached to or forming part of the land, which are agreed to be severed before sale or under the contract of sale. Therefore, most consumer products come under the purview of this definition.

*In Morgan Stanley Mutual Fund v. Kartik Das (1994) 3 CLJ 27*, the Supreme Court held that an application for allotment of shares cannot constitute goods. It is after allotment, rights may arise as per the articles of association of the company. At the stage of application there is no purchase of goods for consideration and again the purchaser cannot be called the hirer of services for consideration.

#### **Who is a not a consumer?**

- A person who obtains;
- goods free of charge
- who avails services free of charge
- who obtains goods for resale or for any commercial purposes
- who avails services for any commercial purposes
- who avails services under contract of service

As per the provisions of the Act, commercial purpose does not include use by a person of goods bought and used by him exclusively for the purposes of earning his livelihood by means of self-employment.

#### **“Consumer dispute”**

Consumer dispute means a dispute where the person against whom a complaint has been made, denies or disputes the allegations contained in the complaint. [Section 2(8)]

#### **“Consumer rights”**

Consumer rights include—

- (i) the right to be protected against the marketing of goods, products or services which are hazardous to life and property;
- (ii) the right to be informed about the quality, quantity, potency, purity, standard and price of goods, products or services, as the case may be, so as to protect the consumer against unfair trade practices;
- (iii) the right to be assured, wherever possible, access to a variety of goods, products or services at competitive prices;
- (iv) the right to be heard and to be assured that consumer's interests will receive due consideration at appropriate fora;
- (v) the right to seek redressal against unfair trade practice or restrictive trade practices or unscrupulous exploitation of consumers; and
- (vi) the right to consumer awareness. [Section 2(9)]

#### **“Defect”**

Defect means any fault, imperfection or shortcoming in the quality, quantity, potency, purity or standard which is required to be maintained by or under any law for the time being in force or under any contract, express or implied or as is claimed by the trader in any manner whatsoever in relation to any goods or product and the expression “defective” shall be construed accordingly. [Section 2(10)]

#### **“Deficiency”**

Deficiency means any fault, imperfection, shortcoming or inadequacy in the quality, nature and manner of performance which is required to be maintained by or under any law for the time being in force or has been undertaken to be performed by a person in pursuance of a contract or otherwise in relation to any service and includes—

- (i) any act of negligence or omission or commission by such person which causes loss or injury to the consumer; and
- (ii) deliberate withholding of relevant information by such person to the consumer.[Section 2(11)]

### **“Design”**

Design in relation to a product, means the intended or known physical and material characteristics of such product and includes any intended or known formulation or content of such product and the usual result of the intended manufacturing or other process used to produce such product. [Section 2(12)]

### **“Direct selling”**

Direct selling means marketing, distribution and sale of goods or provision of services through a network of sellers, other than through a permanent retail location. [Section 2(13)]

### **“Director-General”**

Director-General means the Director-General appointed under section 15(2). [Section 2(14)]

### **“District Commission”**

District Commission means a District Consumer Disputes Redressal Commission established under section 28(1). [Section 2(15)]

### **“E-Commerce”**

E-Commerce means buying or selling of goods or services including digital products over digital or electronic network. [Section 2(16)]

### **“Electronic Service Provider”**

Electronic service provider means a person who provides technologies or processes to enable a product seller to engage in advertising or selling goods or services to a consumer and includes any online market place or online auction sites. [Section 2(17)]

### **“Endorsement”**

Endorsement in relation to an advertisement, means-

- (i) any message, verbal statement, demonstration; or
- (ii) depiction of the name, signature, likeness or other identifiable personal characteristics of an individual; or
- (iii) depiction of the name or seal of any institution or organisation, which makes the consumer to believe that it reflects the opinion, finding or experience of the person making such endorsement. [Section 2(18)]

### **“Establishment”**

Establishment includes an advertising agency, commission agent, manufacturing, trading or any other commercial agency which carries on any business, trade or profession or any work in connection with or incidental or ancillary to any commercial activity, trade or profession, or such other class or classes of persons including public utility entities in the manner as may be prescribed. [Section 2(19)]

### **“Express Warranty”**

Express warranty means any material statement, affirmation of fact, promise or description relating to a product or service warranting that it conforms to such material statement, affirmation, promise or description and includes any sample or model of a product warranting that the whole of such product conforms to such sample or model. [Section 2(20)]

## **“Goods”**

Goods means every kind of movable property and includes “food” as defined in section 3(1)(j) of the Food Safety and Standards Act, 2006.[Section 2(21)]

## **“Harm”**

Harm in relation to a product liability, includes–

- (i) damage to any property, other than the product itself;
- (ii) personal injury, illness or death;
- (iii) mental agony or emotional distress attendant to personal injury or illness or damage to property; or
- (iv) any loss of consortium or services or other loss resulting from a harm referred to in sub-clause (i) or sub-clause (ii) or sub-clause (iii),

but shall not include any harm caused to a product itself or any damage to the property on account of breach of warranty conditions or any commercial or economic loss, including any direct, incidental or consequential loss relating thereto. [Section 2(22)]

## **“Injury”**

Injury means any harm whatever illegally caused to any person, in body, mind or property. [Section 2(23)]

## **“Manufacturer”**

Manufacturer means a person who–

- (i) makes any goods or parts thereof; or
- (ii) assembles any goods or parts thereof made by others; or
- (iii) puts or causes to be put his own mark on any goods made by any other person. [Section 2(24)]

## **“Mediation”**

Mediation means the process by which a mediator mediates the consumer disputes; [Section 2(25)]

## **“Mediator”**

Mediator means a mediator referred to in section 75. [Section 2(26)]

## **“Member”**

Member includes the President and a member of the National Commission or a State Commission or a District Commission, as the case may be. [Section 2(27)]

## **“Misleading Advertisement”**

Misleading Advertisement in relation to any product or service, means an advertisement, which–

- (i) falsely describes such product or service; or
- (ii) gives a false guarantee to, or is likely to mislead the consumers as to the nature, substance, quantity or quality of such product or service; or
- (iii) conveys an express or implied representation which, if made by the manufacturer or seller or service provider thereof, would constitute an unfair trade practice; or
- (iv) deliberately conceals important information. [Section 2(28)]

### **“National Commission”**

National Commission means the National Consumer Disputes Redressal Commission established under section 53(1). [Section 2(29)]

### **“Notification”**

Notification means a notification published in the Official Gazette and the term “notify” shall be construed accordingly. [Section 2(30)]

### **“Person”**

Person includes—

- (i) an individual;
- (ii) a firm whether registered or not;
- (iii) a Hindu undivided family;
- (iv) a co-operative society;
- (v) an association of persons whether registered under the Societies Registration Act, 1860 or not;
- (vi) any corporation, company or a body of individuals whether incorporated or not;
- (vii) any artificial juridical person, not falling within any of the preceding sub-clauses. [Section 2(31)]

### **“Prescribed”**

Prescribed means prescribed by rules made by the Central Government, or, as the case may be, the State Government. [Section 2(32)]

### **“Product”**

product means any article or goods or substance or raw material or any extended cycle of such product, which may be in gaseous, liquid, or solid state possessing intrinsic value which is capable of delivery either as wholly assembled or as a component part and is produced for introduction to trade or commerce, but does not include human tissues, blood, blood products and organs. Section 2(33)]

### **“Product Liability”**

Product liability means the responsibility of a product manufacturer or product seller, of any product or service, to compensate for any harm caused to a consumer by such defective product manufactured or sold or by deficiency in services relating thereto. [Section 2(34)]

### **“Product liability action”**

Product liability action means a complaint filed by a person before a District Commission or State Commission or National Commission, as the case may be, for claiming compensation for the harm caused to him. [Section 2(35)]

### **“Product manufacturer”**

Product manufacturer means a person who—

- (i) makes any product or parts thereof; or
- (ii) assembles parts thereof made by others; or
- (iii) puts or causes to be put his own mark on any products made by any other person; or
- (iv) makes a product and sells, distributes, leases, installs, prepares, packages, labels, markets, repairs, maintains such product or is otherwise involved in placing such product for commercial purpose; or

- (v) designs, produces, fabricates, constructs or re-manufactures any product before its sale; or
- (vi) being a product seller of a product, is also a manufacturer of such product; [Section 2(36)]

### **“Product Seller”**

Product seller in relation to a product, means a person who, in the course of business, imports, sells, distributes, leases, installs, prepares, packages, labels, markets, repairs, maintains, or otherwise is involved in placing such product for commercial purpose and includes—

- (i) a manufacturer who is also a product seller; or
- (ii) a service provider, but does not include—
  - a. a seller of immovable property, unless such person is engaged in the sale of constructed house or in the construction of homes or flats;
  - b. a provider of professional services in any transaction in which, the sale or use of a product is only incidental thereto, but furnishing of opinion, skill or services being the essence of such transaction;
  - c. a person who—
    - (I) acts only in a financial capacity with respect to the sale of the product;
    - (II) is not a manufacturer, wholesaler, distributor, retailer, direct seller or an electronic service provider;
    - (III) leases a product, without having a reasonable opportunity to inspect and discover defects in the product, under a lease arrangement in which the selection, possession, maintenance, and operation of the product are controlled by a person other than the lessor. [Section 2(37)]

### **“Product Service provider”**

Product service provider in relation to a product, means a person who provides any service in respect of such product. [Section 2(38)]

### **“Regulations”**

Regulations means the regulations made by the National Commission, or as the case may be, the Central Authority. [Section 2(39)]

### **“Regulator”**

Regulator means a body or any authority established under any other law for the time being in force. [Section 2(40)]

### **“Restrictive Trade Practice”**

Restrictive trade practice means a trade practice which tends to bring about manipulation of price or its conditions of delivery or to affect flow of supplies in the market relating to goods or services in such a manner as to impose on the consumers unjustified costs or restrictions and shall include—

- (i) delay beyond the period agreed to by a trader in supply of such goods or in providing the services which has led or is likely to lead to rise in the price;
- (ii) any trade practice which requires a consumer to buy, hire or avail of any goods or, as the case may be, services as condition precedent for buying, hiring or availing of other goods or services. [Section 2(41)]

### **“Service”**

Service means service of any description which is made available to potential users and includes, but not limited to, the provision of facilities in connection with banking, financing, insurance, transport, processing, supply of electrical or other energy, telecom, boarding or lodging or both, housing construction, entertainment,

amusement or the purveying of news or other information, but does not include the rendering of any service free of charge or under a contract of personal service. [Section 2(42)]

*The Supreme Court in the case of Indian Merchants Association vs. V P Shantha, (CA No. 688 of 1993 decided on 13th November 1995) observed that a contract for service implies a contract whereby one party undertakes to render services e.g. professional or technical services to or for another in the performance of which he is not subject to detailed direction and control but exercises professional or technical skill and uses his own knowledge and discretion.*

A contract of service on the other hand implies relationship of master and servant and involves an obligation to obey orders in the work to be performed and as to its mode and manner of performance. The Parliamentary draftsman was well aware of this well-accepted distinction between 'contract of service' and 'contract for services' and had deliberately chosen the expression 'contract of service' instead of the expression 'contract for service' in the exclusionary part of the definition of 'service', this being the reason being that an employer could not be regarded as a consumer in respect of the services rendered by his employee in pursuance of contract of employment. By affixing the adjective 'personal' to the word 'service' the nature of the contracts which were excluded were not altered. The adjective only emphasised that what was sought to be excluded was personal service only. The expression contract of personal service in the exclusionary part of Section 2(1)(o) must, therefore, be construed as excluding the services rendered by an employee to his employer under the contract of personal service free from the ambit of the expression service.

### **"Spurious Goods"**

Spurious Goods means such goods which are falsely claimed to be genuine; [Section 2(43)]

### **"State Commission"**

State Commission means a State Consumer Disputes Redressal Commission established under section 42(1). [Section 2(44)]

### **"Trader"**

Trader in relation to any goods, means a person who sells or distributes any goods for sale and includes the manufacturer thereof, and where such goods are sold or distributed in package form, includes the packer thereof. [Section 2(45)]

### **"Unfair Contract"**

Unfair contract means a contract between a manufacturer or trader or service provider on one hand, and a consumer on the other, having such terms which cause significant change in the rights of such consumer, including the following, namely:-

- (i) requiring manifestly excessive security deposits to be given by a consumer for the performance of contractual obligations; or
- (ii) imposing any penalty on the consumer, for the breach of contract thereof which is wholly disproportionate to the loss occurred due to such breach to the other party to the contract; or
- (iii) refusing to accept early repayment of debts on payment of applicable penalty; or
- (iv) entitling a party to the contract to terminate such contract unilaterally, without reasonable cause; or
- (v) permitting or has the effect of permitting one party to assign the contract to the detriment of the other party who is a consumer, without his consent; or
- (vi) imposing on the consumer any unreasonable charge, obligation or condition which puts such consumer to disadvantage; [Section 2(46)]

## “Unfair Trade Practice”

Unfair Trade Practice means a trade practice which, for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:-

- (i) making any statement, whether orally or in writing or by visible representation including by means of electronic record, which-
  - (a) falsely represents that the goods are of a particular standard, quality, quantity, grade, composition, style or model;
  - (b) falsely represents that the services are of a particular standard, quality or grade;
  - (c) falsely represents any re-built, second-hand, renovated, reconditioned or old goods as new goods;
  - (d) represents that the goods or services have sponsorship, approval, performance, characteristics, accessories, uses or benefits which such goods or services do not have;
  - (e) represents that the seller or the supplier has a sponsorship or approval or affiliation which such seller or supplier does not have;
  - (f) makes a false or misleading representation concerning the need for, or the usefulness of, any goods or services;
  - (g) gives to the public any warranty or guarantee of the performance, efficacy or length of life of a product or of any goods that is not based on an adequate or proper test thereof:
 

Provided that where a defence is raised to the effect that such warranty or guarantee is based on adequate or proper test, the burden of proof of such defence shall lie on the person raising such defence;
  - (h) makes to the public a representation in a form that purports to be-
    - (A) a warranty or guarantee of a product or of any goods or services; or
    - (B) a promise to replace, maintain or repair an article or any part thereof or to repeat or continue a service until it has achieved a specified result, if such purported warranty or guarantee or promise is materially misleading or if there is no reasonable prospect that such warranty, guarantee or promise will be carried out;
  - (i) materially misleads the public concerning the price at which a product or like products or goods or services, have been or are, ordinarily sold or provided, and, for this purpose, a representation as to price shall be deemed to refer to the price at which the product or goods or services has or have been sold by sellers or provided by suppliers generally in the relevant market unless it is clearly specified to be the price at which the product has been sold or services have been provided by the person by whom or on whose behalf the representation is made;
  - (j) gives false or misleading facts disparaging the goods, services or trade of another person.

Explanation.-For the purposes of this sub-clause, a statement that is,-

- (A) expressed on an article offered or displayed for sale, or on its wrapper or container; or
  - (B) expressed on anything attached to, inserted in, or accompanying, an article offered or displayed for sale, or on anything on which the article is mounted for display or sale; or
  - (C) contained in or on anything that is sold, sent, delivered, transmitted or in any other manner whatsoever made available to a member of the public, shall be deemed to be a statement made to the public by, and only by, the person who had caused the statement to be so expressed, made or contained;
- (ii) permitting the publication of any advertisement, whether in any newspaper or otherwise, including by way of electronic record, for the sale or supply at a bargain price of goods or services that are not intended to be offered for sale or supply at the bargain price, or for a period that is, and in quantities that are, reasonable, having regard to the nature of the market in which the business is carried on, the nature and size of business, and the nature of the advertisement.

Explanation.—For the purpose of this sub-clause, “bargain price” means,—

- (A) a price that is stated in any advertisement to be a bargain price, by reference to an ordinary price or otherwise; or
- (B) a price that a person who reads, hears or sees the advertisement, would reasonably understand to be a bargain price having regard to the prices at which the product advertised or like products are ordinarily sold;
- (iii) Permitting—
  - (a) the offering of gifts, prizes or other items with the intention of not providing them as offered or creating impression that something is being given or offered free of charge when it is fully or partly covered by the amount charged, in the transaction as a whole;
  - (b) the conduct of any contest, lottery, game of chance or skill, for the purpose of promoting, directly or indirectly, the sale, use or supply of any product or any business interest, except such contest, lottery, game of chance or skill as may be prescribed;
  - (c) withholding from the participants of any scheme offering gifts, prizes or other items free of charge on its closure, the information about final results of the scheme.

Explanation.—For the purpose of this sub-clause, the participants of a scheme shall be deemed to have been informed of the final results of the scheme where such results are within a reasonable time published, prominently in the same newspaper in which the scheme was originally advertised;

- (iv) permitting the sale or supply of goods intended to be used, or are of a kind likely to be used by consumers, knowing or having reason to believe that the goods do not comply with the standards prescribed by the competent authority relating to performance, composition, contents, design, constructions, finishing or packaging as are necessary to prevent or reduce the risk of injury to the person using the goods;
- (v) permitting the hoarding or destruction of goods, or refusal to sell the goods or to make them available for sale or to provide any service, if such hoarding or destruction or refusal raises or tends to raise or is intended to raise, the cost of those or other similar goods or services;
- (vi) manufacturing of spurious goods or offering such goods for sale or adopting deceptive practices in the provision of services;
- (vii) not issuing bill or cash memo or receipt for the goods sold or services rendered in such manner as may be prescribed;
- (viii) refusing, after selling goods or rendering services, to take back or withdraw defective goods or to withdraw or discontinue deficient services and to refund the consideration thereof, if paid, within the period stipulated in the bill or cash memo or receipt or in the absence of such stipulation, within a period of thirty days;
- (ix) disclosing to other person any personal information given in confidence by the consumer unless such disclosure is made in accordance with the provisions of any law for the time being in force. [Section 2(47)]

## CONSUMER PROTECTION COUNCIL

### Central Consumer Protection Council

The Central Government empowers to establish the Central Consumer Protection Council to be known as the Central Council. The Central Council shall be an advisory council and consist of the Minister-in-charge of the Department of Consumer Affairs in the Central Government, who shall be the Chairperson; and such number of other official or non-official members representing such interests as may be prescribed.

The Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year. The Central Council shall meet at such time and place as the Chairperson may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

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The objects of the Central Council shall be to render advice on promotion and protection of the consumers' rights under the Act.

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### **State Consumer Protection Councils**

Every State Government empowers to establish a State Consumer Protection Council for such State to be known as the State Council. The State Council shall be an advisory council and consist of the Minister-in-charge of Consumer Affairs in the State Government who shall be the Chairperson; such number of other official or non-official members representing such interests as may be prescribed and such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

The State Council shall meet as and when necessary but not less than two meetings shall be held every year. The State Council shall meet at such time and place as the Chairperson may think fit and shall observe such procedure in regard to the transaction of its business, as may be prescribed.

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The objects of every State Council shall be to render advice on promotion and protection of consumer rights under the Act within the State.

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### **District Consumer Protection Council**

The State Government empowers to establish for every District with effect from such date as it may specify in such notification, a District Consumer Protection Council to be known as the District Council. The District Council shall be an advisory council and consist the Collector of the district (by whatever name called), who shall be the Chairperson; and such number of other official and non-official members representing such interests as may be prescribed.

The District Council shall meet as and when necessary but not less than two meetings shall be held every year. The District Council shall meet at such time and place within the district as the Chairperson may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

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The objects of every District Council shall be to render advice on promotion and protection of consumer rights under the Act within the district.

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## **CENTRAL CONSUMER PROTECTION AUTHORITY (CCPA)**

### **Establishment of Central Consumer Protection Authority**

Section 10 empowers the Central Government to establish a Central Consumer Protection Authority to be known as the Central Authority to regulate matters relating to violation of rights of consumers, unfair trade practices and false or misleading advertisements which are prejudicial to the interests of public and consumers and to promote, protect and enforce the rights of consumers as a class.

The Central Authority shall consist of a Chief Commissioner and such number of other Commissioners as may be prescribed, to be appointed by the Central Government to exercise the powers and discharge the functions under the Act.

The headquarters of the Central Authority shall be at such place in the National Capital Region of Delhi, and it shall have regional and other offices in any other place in India as the Central Government may decide.

### **Qualifications, method of recruitment, etc., of Chief Commissioner and Commissioners**

The Central Government may, by notification, make rules to provide for the qualifications for appointment, method of recruitment, procedure for appointment, term of office, salaries and allowances, resignation,

removal and other terms and conditions of the service of the Chief Commissioner and Commissioners of the Central Authority.

### **Vacancy, etc., not to invalidate proceedings of Central Authority**

No act or proceeding of the Central Authority shall be invalid merely by reason of-

- (a) any vacancy in, or any defect in the constitution of, the Central Authority; or
- (b) any defect in the appointment of a person acting as the Chief Commissioner or as a Commissioner; or
- (c) any irregularity in the procedure of the Central Authority not affecting the merits of the case.

### **Appointment of officers, experts, professionals and other employees of Central Authority**

Section 13 of the Act deals with Appointment of officers, experts, professionals and other employees of Central Authority. It states that:

- (1) The Central Government shall provide the Central Authority such number of officers and other employees as it considers necessary for the efficient performance of its functions under this Act.
- (2) The salaries and allowances payable to, and the other terms and conditions of service of, the officers and other employees of the Central Authority appointed under this Act shall be such as may be prescribed.
- (3) The Central Authority may engage, in accordance with the procedure specified by regulations, such number of experts and professionals of integrity and ability, who have special knowledge and experience in the areas of consumer rights and welfare, consumer policy, law, medicine, food safety, health, engineering, product safety, commerce, economics, public affairs or administration, as it deems necessary to assist it in the discharge of its functions under this Act.

### **Procedure of Central Authority**

The Central Authority shall regulate the procedure for transaction of its business and allocation of its business amongst the Chief Commissioner and Commissioners as may be specified by regulations. The Chief Commissioner shall have the powers of general superintendence, direction and control in respect of all administrative matters of the Central Authority:

Chief Commissioner may delegate such of his powers relating to administrative matters of the Central Authority, as he may think fit, to any Commissioner (including Commissioner of a regional office) or any other officer of the Central Authority.

### **Investigation Wing of Central Authority**

- The Central Authority shall have an Investigation Wing headed by a Director General for the purpose of conducting inquiry or investigation under this Act as may be directed by the Central Authority.
- The Central Government may appoint a Director General and such number of Additional Director General, Director, Joint Director, Deputy Director and Assistant Director, from amongst persons who have experience in investigation and possess such qualifications, in such manner, as may be prescribed.
- Every Additional Director General, Director, Joint Director, Deputy Director and Assistant Director shall exercise his powers, and discharge his functions, subject to the general control, supervision and direction of the Director-General.
- The Director General may delegate all or any of his powers to the Additional Director General or Director, Joint Director or Deputy Director or Assistant Director, as the case may be, while conducting inquiries or investigations under this Act.
- The inquiries or the investigations made by the Director General shall be submitted to the Central Authority in such form, in such manner and within such time, as may be specified by regulations.

## Power of District Collector

Section 16 of the Act provides that the District Collector (by whatever name called) may, on a complaint or on a reference made to him by the Central Authority or the Commissioner of a regional office, inquire into or investigate complaints regarding violation of rights of consumers as a class, on matters relating to violations of consumer rights, unfair trade practices and false or misleading advertisements, within his jurisdiction and submit his report to the Central Authority or to the Commissioner of a regional office, as the case may be.

## Complaints to Authorities

A complaint relating to violation of consumer rights or unfair trade practices or false or misleading advertisements which are prejudicial to the interests of consumers as a class, may be forwarded either in writing or in electronic mode, to any one of the authorities, namely, the District Collector or the Commissioner of regional office or the Central Authority.

## Powers and functions of Central Authority

According to section 18(1) the Central Authority empowers to:

- (a) protect, promote and enforce the rights of consumers as a class, and prevent violation of consumers rights under this Act;
- (b) prevent unfair trade practices and ensure that no person engages himself in unfair trade practices;
- (c) ensure that no false or misleading advertisement is made of any goods or services which contravenes the provisions of this Act or the rules or regulations made thereunder;
- (d) ensure that no person takes part in the publication of any advertisement which is false or misleading.

Section 18(2) states that without prejudice to the generality of the provisions contained in Section 18 (1), the Central Authority may, for any of the purposes aforesaid,-

- (a) inquire or cause an inquiry or investigation to be made into violations of consumer rights or unfair trade practices, either suo motu or on a complaint received or on the directions from the Central Government;
- (b) file complaints before the District Commission, the State Commission or the National Commission, as the case may be, under this Act;
- (c) intervene in any proceedings before the District Commission or State Commission or National Commission, as the case may be, in respect of any allegation of violation of consumer rights or unfair trade practices;
- (d) review the matters relating to, and the factors inhibiting enjoyment of, consumer rights, including safeguards provided for the protection of consumers under any other law for the time being in force and recommend appropriate remedial measures for their effective implementation;
- (e) recommend adoption of international covenants and best international practices on consumer rights to ensure effective enforcement of consumer rights;
- (f) undertake and promote research in the field of consumer rights;
- (g) spread and promote awareness on consumer rights;
- (h) encourage non-Governmental organisations and other institutions working in the field of consumer rights to co-operate and work with consumer protection agencies;
- (i) mandate the use of unique and universal goods identifiers in such goods, as may be necessary, to prevent unfair trade practices and to protect consumers' interest;
- (j) issue safety notices to alert consumers against dangerous or hazardous or unsafe goods or services;
- (k) advise the Ministries and Departments of the Central and State Governments on consumer welfare measures;
- (l) issue necessary guidelines to prevent unfair trade practices and protect consumers' interest.

### **Power of Central Authority to refer matter for investigation or to other Regulator**

Section 19(1) of the Act provides that the Central Authority may, after receiving any information or complaint or directions from the Central Government or of its own motion, conduct or cause to be conducted a preliminary inquiry as to whether there exists a *prima facie* case of violation of consumer rights or any unfair trade practice or any false or misleading advertisement, by any person, which is prejudicial to the public interest or to the interests of consumers and if it is satisfied that there exists a *prima facie* case, it shall cause investigation to be made by the Director General or by the District Collector.

According to Section 19(2) where, after preliminary inquiry, the Central Authority is of the opinion that the matter is to be dealt with by a Regulator established under any other law for the time being in force, it may refer such matter to the concerned Regulator along with its report.

Section 19 (3) states that for the purposes of investigation, the Central Authority, the Director General or the District Collector may call upon a person referred to in Section 19(1) and also direct him to produce any document or record in his possession.

### **Power of Central Authority to recall goods**

As per section 20 of the Act where the Central Authority is satisfied on the basis of investigation that there is sufficient evidence to show violation of consumer rights or unfair trade practice by a person, it may pass such order as may be necessary, including—

- (a) recalling of goods or withdrawal of services which are dangerous, hazardous or unsafe;
- (b) reimbursement of the prices of goods or services so recalled to purchasers of such goods or services; and
- (c) Discontinuation of practices which are unfair and prejudicial to consumers' interest: Provided that the Central Authority shall give the person an opportunity of being heard before passing an order under this section.

### **Power of Central Authority to issue directions and penalties against false or misleading advertisements**

Section 21 provides that where the Central Authority is satisfied after investigation that any advertisement is false or misleading and is prejudicial to the interest of any consumer or is in contravention of consumer rights, it may, by order, issue directions to the concerned trader or manufacturer or endorser or advertiser or publisher, as the case may be, to discontinue such advertisement or to modify the same in such manner and within such time as may be specified in that order.

If the Central Authority is of the opinion that it is necessary to impose a penalty in respect of such false or misleading advertisement, by a manufacturer or an endorser, it may, by order, impose on manufacturer or endorser a penalty which may extend to ten lakh rupees. The Central Authority may, for every subsequent contravention by a manufacturer or endorser, impose a penalty, which may extend to fifty lakh rupees.

Where the Central Authority deems it necessary, it may, by order, prohibit the endorser of a false or misleading advertisement from making endorsement of any product or service for a period which may extend to one year. Central Authority may, for every subsequent contravention, prohibit such endorser from making endorsement in respect of any product or service for a period which may extend to three years.

Where the Central Authority is satisfied after investigation that any person is found to publish, or is a party to the publication of, a misleading advertisement, it may impose on such person a penalty which may extend to ten lakh rupees.

No endorser shall be liable to a penalty, if he has exercised due diligence to verify the veracity of the claims made in the advertisement regarding the product or service being endorsed by him.

No person shall be liable to such penalty if he proves that he had published or arranged for the publication of such advertisement in the ordinary course of his business: Provided that no such defence shall be available to

such person if he had previous knowledge of the order passed by the Central Authority for withdrawal or modification of such advertisement.

While determining the penalty, regard shall be had to the following, namely:-

- (a) the population and the area impacted or affected by such offence;
- (b) the frequency and duration of such offence;
- (c) the vulnerability of the class of persons likely to be adversely affected by such offence; and
- (d) the gross revenue from the sales effected by virtue of such offence.

The Central Authority shall give the person an opportunity of being heard before an order under this section is passed.

### Search and seizure

According to section 22 of the Act, for the purpose of conducting an investigation after preliminary inquiry under section 19(1), the Director General or any other officer authorised by him in this behalf, or the District Collector, as the case may be, may, if he has any reason to believe that any person has violated any consumer rights or committed unfair trade practice or causes any false or misleading advertisement to be made, shall,-

- (a) enter at any reasonable time into any such premises and search for any document or record or article or any other form of evidence and seize such document, record, article or such evidence;
- (b) make a note or an inventory of such record or article; or
- (c) require any person to produce any record, register or other document or article.

The provisions of the Code of Criminal Procedure, 1973, relating to search and seizure shall apply, as far as may be, for search and seizure under this Act.

Every document, record or article seized or produced shall be returned to the person, from whom they were seized or who produced the same, within a period of twenty days of the date of such seizure or production, as the case may be, after copies thereof or extracts therefrom certified by that person, in such manner as may be prescribed, have been taken.

Where any article seized are subject to speedy or natural decay, the Director General or such other officer may dispose of the article in such manner as may be prescribed.

In the case of articles other than the articles of speedy or natural decay, provisions contained in section 38(2) shall *mutatis mutandis* apply in relation to analysis or tests.

Section 38(2)(c) provides that if the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, obtain a sample of the goods from the complainant, seal it and authenticate it in the manner as may be prescribed and refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory to make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereon to the District Commission within a period of forty-five days of the receipt of the reference or within such extended period as may be granted by it.

### Vexatious Search

The Director General or any other officer, exercising powers under section 22, who knows that there are no reasonable grounds for so doing, and yet-

- (a) searches, or causes to be searched any premises; or
- (b) seizes any record, register or other document or article, shall, for every such offence, be punished with imprisonment for a term which may extend to one year, or with fine which may extend to ten thousand rupees or with both.

## Designation of any statutory authority or body to function as Central Authority

Section 23 empowers the Central Government may, if it considers necessary, by notification, designate any statutory authority or body to exercise the powers and perform the functions of the Central Authority referred to in section 10.

### Appeal

Section 24 provides that a person aggrieved by any order passed by the Central Authority under sections 20 and 21 may file an appeal to the National Commission within a period of thirty days from the date of receipt of such order.

## District Consumer Disputes Redressal Commission

Section 28 of the Act, empowers the State Government to establish a District Consumer Disputes Redressal Commission, to be known as the District Commission, in each district of the State. State Government may also, if it deems fit, establish more than one District Commission in a district.

Each District Commission shall consist of- (a) a President; and (b) not less than two and not more than such number of members as may be prescribed, in consultation with the Central Government.

### Qualifications of President and members of District Commission

The Central Government may, by notification, make rules to provide for the qualifications, method of recruitment, procedure for appointment, term of office, resignation and removal of the President and members of the District Commission.

### Jurisdiction of District Commission

According to section 34 the District Commission shall have jurisdiction to entertain complaints where the value of the goods or services paid as consideration does not exceed one crore rupees.

***A complaint shall be instituted in a District Commission within the local limits of whose jurisdiction,-***

- (a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, ordinarily resides or carries on business or has a branch office or personally works for gain; or
- (b) any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided that in such case the permission of the District Commission is given; or
- (c) the cause of action, wholly or in part, arises; or
- (d) the complainant resides or personally works for gain.

The District Commission shall ordinarily function in the district headquarters and may perform its functions at such other place in the district, as the State Government may, in consultation with the State Commission, notify in the Official Gazette from time to time.

### Manner in which complaint shall be made

Section 35 provides that a complaint, in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided, may be filed with a District Commission by-

- (a) the consumer,-
  - (i) to whom such goods are sold or delivered or agreed to be sold or delivered or such service is provided or agreed to be provided; or
  - (ii) who alleges unfair trade practice in respect of such goods or service;

- (b) any recognised consumer association, whether the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service is provided or agreed to be provided, or who alleges unfair trade practice in respect of such goods or service, is a member of such association or not;
- (c) one or more consumers, where there are numerous consumers having the same interest, with the permission of the District Commission, on behalf of, or for the benefit of, all consumers so interested; or
- (d) The Central Government, the Central Authority or the State Government, as the case may be.

It may be noted that the **complaint may be filed electronically** in prescribed manner.

**"Recognised Consumer Association"** means any voluntary consumer association registered under any law for the time being in force.

(2) Every complaint filed shall be accompanied with such fee and payable in such manner, including electronic form, as may be prescribed.

### Proceedings before District Commission

According to Section 36 every proceeding before the District Commission shall be conducted by the President of that Commission and at least one member thereof, sitting together.

It may be noted that where a member, for any reason, is unable to conduct a proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.

On receipt of a complaint made under section 35, the District Commission may, by order, admit the complaint for being proceeded with or reject the same.

A complaint shall not be rejected unless **an opportunity of being heard** has been given to the complainant. The admissibility of the complaint shall ordinarily be decided within **twenty-one days** from the date on which the complaint was filed.

Where the District Commission does not decide the issue of admissibility of the complaint within the period so specified, it shall be deemed to have been admitted.

### Reference to mediation

According to Section 37 at the first hearing of the complaint after its admission, or at any later stage, if it appears to the District Commission that there exists elements of a settlement which may be acceptable to the parties, except in such cases as may be prescribed, it may direct the parties to give in writing, within five days, consent to have their dispute settled by mediation in accordance with the provisions of Chapter V.

Where the parties agree for settlement by mediation and give their consent in writing, the District Commission shall, **within five days of receipt** of such consent, refer the matter for mediation, and in such case, the provisions of Chapter V, relating to mediation, shall apply.

### Procedure on admission of complaint

Section 38 deals with procedure on admission of complaint by the District Commission. Section 38 provides that:

- (1) The District Commission shall, on admission of a complaint, or in respect of cases referred for mediation on failure of settlement by mediation, proceed with such complaint.
- (2) Where the complaint relates to any goods, the District Commission shall,–
  - (a) refer a copy of the admitted complaint, within twenty-one days from the date of its admission to the opposite party mentioned in the complaint directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by it;

- (b) if the opposite party on receipt of a complaint referred to him under clause (a) denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Commission, proceed to settle the consumer dispute in the manner specified in clauses (c) to (g);
  - (c) if the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, obtain a sample of the goods from the complainant, seal it and authenticate it in the manner as may be prescribed and refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory to make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereon to the District Commission within a period of forty-five days of the receipt of the reference or within such extended period as may be granted by it;
  - (d) before any sample of the goods is referred to any appropriate laboratory under clause (c), require the complainant to deposit to the credit of the Commission such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question;
  - (e) remit the amount deposited to its credit under clause (d) to the appropriate laboratory to enable it to carry out the analysis or test mentioned in clause (c) and on receipt of the report from the appropriate laboratory, it shall forward a copy of the report along with such remarks as it may feel appropriate to the opposite party;
  - (f) if any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the methods of analysis or test adopted by the appropriate laboratory, require the opposite party or the complainant to submit in writing his objections with regard to the report made by the appropriate laboratory;
  - (g) give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto under clause (f) and issue an appropriate order under section 39.
- (3) The District Commission shall, if the complaint admitted by it under section 36 relates to goods in respect of which the procedure specified in sub-section (2) cannot be followed, or if the complaint relates to any services,-
- (a) refer a copy of such complaint to the opposite party directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the District Commission;
  - (b) if the opposite party, on receipt of a copy of the complaint, referred to him under clause (a) denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Commission, it shall proceed to settle the consumer dispute-
    - (i) on the basis of evidence brought to its notice by the complainant and the opposite party, if the opposite party denies or disputes the allegations contained in the complaint, or
    - (ii) ex parte on the basis of evidence brought to its notice by the complainant, where the opposite party omits or fails to take any action to represent his case within the time given by the Commission;
  - (c) decide the complaint on merits if the complainant fails to appear on the date of hearing.
- (4) For the purposes of sub-sections (2) and (3), the District Commission may, by order, require an electronic service provider to provide such information, documents or records, as may be specified in that order.
- (5) No proceedings complying with the procedure laid down in sub-sections (1) and (2) shall be called in question in any court on the ground that the principles of natural justice have not been complied with.
- (6) Every complaint shall be heard by the District Commission on the basis of affidavit and documentary evidence placed on record: Provided that where an application is made for hearing or for examination of

parties in person or through video conferencing, the District Commission may, on sufficient cause being shown, and after recording its reasons in writing, allow the same.

- (7) Every complaint shall be disposed of as expeditiously as possible and endeavour shall be made to decide the complaint within a period of three months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities: Provided that no adjournment shall ordinarily be granted by the District Commission unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the Commission: Provided further that the District Commission shall make such orders as to the costs occasioned by the adjournment as may be specified by regulations: Provided also that in the event of a complaint being disposed of after the period so specified, the District Commission shall record in writing, the reasons for the same at the time of disposing of the said complaint.
- (8) Where during the pendency of any proceeding before the District Commission, if it appears necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case.
- (9) For the purposes of this section, the District Commission shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:-
  - (a) the summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;
  - (b) requiring the discovery and production of any document or other material object as evidence;
  - (c) receiving of evidence on affidavits;
  - (d) the requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;
  - (e) issuing of commissions for the examination of any witness, or document; and
  - (f) any other matter which may be prescribed by the Central Government.
- (10) Every proceeding before the District Commission shall be deemed to be a judicial proceeding within the meaning of sections 193 and 228 of the Indian Penal Code, and the District Commission shall be deemed to be a criminal court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.
- (11) Where the complainant is a consumer referred to in sub-clause (v) of clause (5) of section 2, the provisions of Order I Rule 8 of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to a suit or decree shall be construed as a reference to a complaint or the order of the District Commission thereon.
- (12) In the event of death of a complainant who is a consumer or of the opposite party against whom the complaint has been filed, the provisions of Order XXII of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to the plaintiff and the defendant shall be construed as reference to a complainant or the opposite party, as the case may be.

### Findings of District Commission

Section 39(1) of the Act states that where the District Commission is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services or any unfair trade practices, or claims for compensation under product liability are proved, it shall issue an order to the opposite party directing him to do one or more of the following, namely:–

- (a) to remove the defect pointed out by the appropriate laboratory from the goods in question;
- (b) to replace the goods with new goods of similar description which shall be free from any defect;
- (c) to return to the complainant the price, or, as the case may be, the charges paid by the complainant along with such interest on such price or charges as may be decided;
- (d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party: Provided that the District Commission shall have the power to grant punitive damages in such circumstances as it deems fit;

- (e) to pay such amount as may be awarded by it as compensation in a product liability action under Chapter VI;
- (f) to remove the defects in goods or deficiencies in the services in question;
- (g) to discontinue the unfair trade practice or restrictive trade practice and not to repeat them;
- (h) not to offer the hazardous or unsafe goods for sale;
- (i) to withdraw the hazardous goods from being offered for sale;
- (j) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;
- (k) to pay such sum as may be determined by it, if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently. it may be noted that the minimum amount of sum so payable shall not be less than twenty-five per cent. of the value of such defective goods sold or service provided, as the case may be, to such consumers;
- (l) to issue corrective advertisement to neutralise the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;
- (m) to provide for adequate costs to parties; and
- (n) to cease and desist from issuing any misleading advertisement.

Section 39(2) provides that any amount obtained shall be credited to such fund and utilised in such manner as may be prescribed.

According to Section 39(3), in any proceeding conducted by the President and a member and if they differ on any point or points, they shall state the point or points on which they differ and refer the same to another member for hearing on such point or points and the opinion of the majority shall be the order of the District Commission. However, the other member shall give his opinion on such point or points referred to him within a period of one month from the date of such reference.

Every order made by the District Commission shall be signed by the President and the member who conducted the proceeding. Provided that where the order is made as per majority opinion under sub-section (3), such order shall also be signed by the other member.[Section 39(4)]

### Review by District Commission in Certain Case

Section 40 empowers the District Commission to review any of the order passed by it if there is an error apparent on the face of the record, either of its own motion or on an application made by any of the parties within thirty days of such order.

### Appeal against order of District Commission

According to Section 41 of the Act any person aggrieved by an order made by the District Commission may prefer an appeal against such order to the State Commission on the grounds of facts or law within a period of **forty-five days** from the date of the order, in such form and manner, as may be prescribed. It may be noted that the State Commission may entertain an appeal after the expiry of the said period of forty-five days, if it is satisfied that there was sufficient cause for not filing it within that period.

*There are certain restriction on appeal, unless the person fulfil the following conditions namely-*

- No appeal by a person, who is required to pay any amount in terms of an order of the District Commission, shall be entertained by the State Commission unless the appellant has deposited fifty per cent. of that amount in the manner as may be prescribed.
- No appeal shall lie from any order passed under sub-section (1) of section 81 by the District Commission pursuant to a settlement by mediation under section 80.

### State Consumer Disputes Redressal Commission

Section 42 empowers the State Government to establish a State Consumer Disputes Redressal Commission, to be known as the State Commission, in the State. The State Commission shall ordinarily function at the State

capital and perform its functions at such other places as the State Government may in consultation with the State Commission notify in the Official Gazette. State Government also empowers to establish regional benches of the State Commission, at such places, as it deems fit.

Each State Commission shall consist of-

- (a) a President; and
- (b) not less than four or not more than such number of members as may be prescribed in consultation with the Central Government.

### Qualifications, etc., of President and members of State Commission

The Central Government may, by notification, make rules to provide for the qualification for appointment, method of recruitment, procedure of appointment, term of office, resignation and removal of the President and members of the State Commission.

### Jurisdiction of State Commission

According to Section 47(1) of the Act, State Commission shall have jurisdiction-

- (a) to entertain-
  - (i) complaints where the value of the goods or services paid as consideration, exceeds rupees one crore, but does not exceed rupees ten crore: Provided that where the Central Government deems it necessary so to do, it may prescribe such other value, as it deems fit;
  - (ii) complaints against unfair contracts, where the value of goods or services paid as consideration **does not exceed ten crore rupees**;
  - (iii) appeals against the orders of any District Commission within the State; and
- (b) to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Commission within the State, where it appears to the State Commission that such District Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity.

Section 47(2) provides that the jurisdiction, powers and authority of the State Commission may be exercised by **BENCHES** thereof, and a Bench may be constituted by the President with one or more members as the President may deem fit. It may be noted that the senior-most member shall preside over the Bench.

Section 47(3) states that where the members of a Bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and make a reference to the President who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other members and such point or points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it. The President or the other members, as the case may be, shall give opinion on the point or points so referred within a period of one month from the date of such reference.

According to Section 47(4), a complaint shall be instituted in a State Commission within the limits of whose jurisdiction,-

- (a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, ordinarily resides or carries on business or has a branch office or personally works for gain; or
- (b) any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain, provided in such case, the permission of the State Commission is given; or
- (c) the cause of action, wholly or in part, arises; or
- (d) the complainant resides or personally works for gain.

## Procedure applicable to State Commission

Section 49 states that the provisions relating to complaints under sections 35, 36, 37, 38 and 39 shall, with such modifications as may be necessary, be applicable to the disposal of complaints by the State Commission.

The State Commission may also declare any terms of contract, which is unfair to any consumer, to be null and void.

## Review by State Commission in Certain Case

Section 50 empowers the State Commission to review any of the order passed by it if there is an error apparent on the face of the record, either of its own motion or on an application made by any of the parties within thirty days of such order.

## Appeal to National Commission

Section 51(1) provides that any person aggrieved by an order made by the State Commission in exercise of its powers conferred by Section 47(1)(a)(i) or section 47(1)(a)(ii) may prefer an appeal against such order to the National Commission within a period of thirty days from the date of the order in such form and manner as may be prescribed. National Commission shall not entertain the appeal after the expiry of the said period of thirty days unless it is satisfied that there was sufficient cause for not filing it within that period. Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission unless the appellant has deposited fifty per cent. of that amount in the manner as may be prescribed.

Section 51 (2) states that save as otherwise expressly provided under this Act or by any other law for the time being in force, an appeal shall lie to the National Commission from any order passed in appeal by any State Commission, if the National Commission is satisfied that the case involves a substantial question of law.

According to Section 51(3), in an appeal involving a question of law, the memorandum of appeal shall precisely state the substantial question of law involved in the appeal.

Section 51(4) provides that where the National Commission is satisfied that a substantial question of law is involved in any case, it shall formulate that question and hear the appeal on that question. Further, nothing in this sub-section shall be deemed to take away or abridge the power of the National Commission to hear, for reasons to be recorded in writing, the appeal on any other substantial question of law, if it is satisfied that the case involves such question of law.

An appeal may lie to the National Commission from an order passed ex parte by the State Commission.

## Hearing of appeal by State Commission or National Commission

According to Section 52 of the Act, an appeal filed before the State Commission or the National Commission, as the case may be, shall be heard as expeditiously as possible and every endeavour shall be made to dispose of the appeal within a period of **ninety days** from the date of its admission.

Adjournment shall not ordinarily be granted by the State Commission or the National Commission, as the case may be, unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by such Commission.

State Commission or the National Commission, as the case may be, shall make such orders as to the costs occasioned by the adjournment, as may be specified by regulations.

In the event of an appeal being disposed of after the period so specified, the State Commission or the National Commission, as the case may be, shall record in writing the reasons for the same at the time of disposing of the said appeal.

## National Consumer Disputes Redressal Commission

Section 53 empowers the Central Government to establish a National Consumer Disputes Redressal Commission, to be known as the National Commission. The National Commission shall ordinarily function at the National Capital Region and perform its functions at such other places as the Central Government may in consultation with the National Commission notify in the Official Gazette. Central Government may also establish regional Benches of the National Commission, at such places, as it deems fit.

### Composition of National Commission

Section 54 provides that the National Commission shall consist of-

- (a) a President; and
- (b) not less than four and not more than such number of members as may be prescribed.

### Qualifications, etc., of President and members of National Commission

Section 55 states that the Central Government may, by notification, make rules to provide for qualifications, appointment, term of office, salaries and allowances, resignation, removal and other terms and conditions of service of the President and members of the National Commission.

President and members of the National Commission shall hold office for such term as specified in the rules made by the Central Government but not exceeding five years from the date on which he enters upon his office and shall be eligible for reappointment.

It may be noted that no President or members shall hold office as such after he has attained such age as specified in the rules made by the Central Government which shall not exceed, –

- (a) in the case of the President, the age of seventy years;
- (b) in the case of any other member, the age of sixty-seven years.

### Jurisdiction of National Commission

Section 58(1) of the Act provides that subject to the other provisions of this Act, the National Commission shall have jurisdiction–

- (a) To entertain–
  - (i) Complaints where the value of the goods or services paid as consideration **exceeds rupees ten crore**. Further, where the Central Government deems it necessary so to do, it may prescribe such other value, as it deems fit.
  - (ii) Complaints against unfair contracts, where the value of goods or services paid as consideration exceeds ten crore rupees;
  - (iii) Appeals against the orders of any State Commission;
  - (iv) Appeals against the orders of the Central Authority; and
- (b) to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any State Commission where it appears to the National Commission that such State Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested, or has acted in the exercise of its jurisdiction illegally or with material irregularity.

According to Section 58(2), the jurisdiction, powers and authority of the National Commission may be exercised by Benches thereof and a Bench may be constituted by the President with one or more members as he may deem fit. The senior-most member of the Bench shall preside over the Bench.

Section 58(3) states that where the members of a Bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided,

they shall state the point or points on which they differ, and make a reference to the President who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other members and such point or points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it. The President or the other member, as the case may be, shall give opinion on the point or points so referred within a period of two months from the date of such reference.

### Procedure Applicable to National Commission

Section 59 provides that the provisions relating to complaints under sections 35, 36, 37, 38 and 39 shall, with such modifications as may be considered necessary, be applicable to the disposal of complaints by the National Commission.

National Commission may also declare any terms of contract, which is unfair to any consumer to be null and void.

### Review by National Commission in Certain Cases

Section 60 empowers the National Commission to review any of the order passed by it if there is an error apparent on the face of the record, either of its own motion or on an application made by any of the parties within thirty days of such order.

### Power to set aside ex parte Orders

Where an order is passed by the National Commission ex parte, the aggrieved party may make an application to the Commission for setting aside such order.

### Procedures for Service of Notice

Section 65(1) states that all notices, required by this Act to be served, shall be served by delivering or transmitting a copy thereof by registered post acknowledgment due addressed to opposite party against whom complaint is made or to the complainant by ***speed post or by such courier service***, approved by the District Commission, the State Commission or the National Commission, as the case may be, or by any other mode of transmission of documents including electronic means.

Section 65 (2) provides that without prejudice to the provisions contained in sub-section (1), the notice required by this Act may be served on an electronic service provider at the address provided by it on the ***electronic platform*** from where it provides its services as such and for this purpose, the electronic service provider shall designate a nodal officer to accept and process such notices.

According to Section 65 (3), when an acknowledgment or any other receipt purporting to be signed by the opposite party or his agent or, as the case may be, by the complainant is received by the District Commission, the State Commission or the National Commission, as the case may be, or postal article containing the notice is received back by such District Commission, State Commission or the National Commission, with an endorsement purporting to have been made by a postal employee or by any person authorised by the courier service to the effect that the opposite party or his agent or complainant had refused to take delivery of the postal article containing the notice or had refused to accept the notice by any other means specified in sub-section

when tendered or transmitted to him, the District Commission or the State Commission or the National Commission, as the case may be, shall declare that the notice has been duly served on the opposite party or to the complainant, as the case may be:

Provided that where the notice was properly addressed, pre-paid and duly sent by registered post acknowledgment due, a declaration referred to in this sub-section shall be made notwithstanding the fact that the acknowledgment has been lost or misplaced, or for any other reason, has not been received by the District Commission, the State Commission or the National Commission, as the case may be, within thirty days from the date of issue of notice.

Section 65 (4) states that all notices required to be served on an opposite party or to complainant, as the case may be, shall be deemed to be sufficiently served, if addressed in the case of the opposite party, to the place where business or profession is carried on, and in case of the complainant, the place where such person actually and voluntarily resides.

### Experts to Assist National Commission or State Commission

Section 66 of the Act provides that where the National Commission or the State Commission, as the case may be, on an application by a complainant or otherwise, is of the opinion that it involves the larger interest of consumers, it may direct any individual or organisation or expert to assist the National Commission or the State Commission, as the case may be.

### Appeal against Order of National Commission

According to Section 67 of the Act, any person, aggrieved by an order made by the National Commission may prefer an appeal against such order to the Supreme Court within a period of thirty days from the date of the order.

Provided that the Supreme Court may entertain an appeal after the expiry of the said period of thirty days if it is satisfied that there was sufficient cause for not filing it within that period.

Provided further that no appeal by a person who is required to pay any amount in terms of an order of the National Commission shall be entertained by the Supreme Court unless that person has deposited fifty per cent. of that amount in the manner as may be prescribed.

### Finality of Orders

Section 68 states that every order of a District Commission or the State Commission or the National Commission, as the case may be, shall, if no appeal has been preferred against such order under the provisions of this Act, be final.

### Limitation Period

Section 69 provides that the District Commission, the State Commission or the National Commission shall not admit a complaint unless it is filed within two years from the date on which the cause of action has arisen.

A complaint may be entertained after the period specified above, if the complainant satisfies the District Commission, the State Commission or the National Commission, as the case may be, that he had sufficient cause for not filing the complaint within such period:

A complaint shall not be entertained unless the District Commission or the State Commission or the National Commission, as the case may be, records its reasons for condoning such delay.

| Pecuniary jurisdiction of Commissions |                        |
|---------------------------------------|------------------------|
| Commissions                           | Pecuniary jurisdiction |
| District Commission                   | Upto 1 cr              |
| State Commission                      | 1 cr – 10 cr           |
| National Commission                   | Above 10 cr            |

### Enforcement of Orders of District Commission, State Commission and National Commission

According to the Section 71 of the Act, every order made by a District Commission, State Commission or the National Commission shall be enforced by it in the same manner as if it were a decree made by a Court in a suit before it and the provisions of Order XXI of the First Schedule to the Code of Civil Procedure, 1908 shall, as far as may be, applicable, subject to the modification that every reference therein to the decree shall be construed as reference to the order made under the Act.

## Penalty for Noncompliance of Order

Section 72(1) provides that whoever fails to comply with any order made by the District Commission or the State Commission or the National Commission, as the case may be, shall be punishable with imprisonment for a term which shall not be less than one month, but which may extend to three years, or with fine, which shall not be less than twenty-five thousand rupees, but which may extend to one lakh rupees, or with both.

According to Section 72(2) of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973, the District Commission, the State Commission or the National Commission, as the case may be, shall have the power of a Judicial Magistrate of First Class for the trial of offences under sub-section (1), and on conferment of such powers, the District Commission or the State Commission or the National Commission, as the case may be, shall be deemed to be a Judicial Magistrate of First Class for the purposes of the Code of Criminal Procedure, 1973.

Section 72(3) states that save as otherwise provided, the offences under sub-section (1) shall be tried summarily by the District Commission or the State Commission or the National Commission, as the case may be.

## Appeal against Order Passed under Section 72

Section 73 provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, where an order is passed under section 72(1), an appeal shall lie, both on facts and on law from-

- (a) the order made by the District Commission to the State Commission;
- (b) the order made by the State Commission to the National Commission; and
- (c) the order made by the National Commission to the Supreme Court.

Every appeal shall be preferred within a period of thirty days from the date of order of a District Commission or a State Commission or the National Commission, as the case may be.

It may be noted that the State Commission or the National Commission or the Supreme Court, as the case may be, may entertain an appeal after the expiry of the said period of thirty days, if it is satisfied that the appellant had sufficient cause for not preferring the appeal within the said period of thirty days.

Appeal shall not lie before any court, from any order of a District Commission or a State Commission or the National Commission, as the case may be.

## MEDIATION

### Establishment of Consumer Mediation Cell

Section 74 empowers the State Government to establish a consumer mediation cell to be attached to each of the District Commissions and the State Commissions of that State.

Further the Central Government also empowers to establish a consumer mediation cell to be attached to the National Commission and each of the regional Benches.

A consumer mediation cell shall consist of such persons as may be prescribed. Every consumer mediation cell shall maintain-

- (a) a list of empanelled mediators;
- (b) a list of cases handled by the cell;
- (c) record of proceeding; and
- (d) any other information as may be specified by regulations.

Every consumer mediation cell shall submit a quarterly report to the District Commission, State Commission or the National Commission to which it is attached, in the manner specified by regulations.

## Empanelment of Mediators

Section 75(1) of the Act provides that for the purpose of mediation, the National Commission or the State Commission or the District Commission, as the case may be, shall prepare a panel of the mediators to be maintained by the consumer mediation cell attached to it, on the recommendation of a selection committee consisting of the President and a member of that Commission.

The qualifications and experience required for empanelment as mediator, the procedure for empanelment, the manner of training empanelled mediators, the fee payable to empanelled mediator, the terms and conditions for empanelment, the code of conduct for empanelled mediators, the grounds on which, and the manner in which, empanelled mediators shall be removed or empanelment shall be cancelled and other matters relating thereto, shall be such as may be specified by regulations.

The panel of mediators prepared under sub-section (1) shall be valid for a period of five years, and the empanelled mediators shall be eligible to be considered for re-empanelment for another term, subject to such conditions as may be specified by regulations.

## Nomination of Mediators from Panel

Section 76 states that the District Commission, the State Commission or the National Commission shall, while nominating any person from the panel of mediators referred to in section 75, consider his suitability for resolving the consumer dispute involved

### Duty of Mediator to Disclose Certain Fact

According to the Section 77 of the Act, it shall be the duty of the mediator to disclose—

- (a) any personal, professional or financial interest in the outcome of the consumer dispute;
- (b) the circumstances which may give rise to a justifiable doubt as to his independence or impartiality; and
- (c) such other facts as may be specified by regulations.

## Replacement of Mediator in Certain Cases

Section 78 of the Act provides that where the District Commission or the State Commission or the National Commission, as the case may be, is satisfied, on the information furnished by the mediator or on the information received from any other person including parties to the complaint and after hearing the mediator, it shall replace such mediator by another mediator.

## Procedure for Mediation

Section 79 states that the mediation shall be held in the consumer mediation cell attached to the District Commission, the State Commission or the National Commission, as the case may be.

Where a consumer dispute is referred for mediation by the District Commission or the State Commission or the National Commission, as the case may be, the mediator nominated by such Commission shall have regard to the rights and obligations of the parties, the usages of trade, if any, the circumstances giving rise to the consumer dispute and such other relevant factors, as he may deem necessary and shall be guided by the principles of natural justice while carrying out mediation.

The mediator so nominated shall conduct mediation within such time and in such manner as may be specified by regulations.

## Settlement through Mediation

Section 80(1) provides that pursuant to mediation, if an agreement is reached between the parties with respect to all of the issues involved in the consumer dispute or with respect to only some of the issues, the terms of such

agreement shall be reduced to writing accordingly, and signed by the parties to such dispute or their authorised representatives.

Section 80(2) states that the mediator shall prepare a settlement report of the settlement and forward the signed agreement along with such report to the concerned Commission.

Where no agreement is reached between the parties within the specified time or the mediator is of the opinion that settlement is not possible, he shall prepare his report accordingly and submit the same to the concerned Commission.

### Recording Settlement and Passing of Order

According to Section 81(1) the District Commission or the State Commission or the National Commission, as the case may be, shall, within seven days of the receipt of the settlement report, pass suitable order recording such settlement of consumer dispute and dispose of the matter accordingly.

Section 81(2) provides that where the consumer dispute is settled only in part, the District Commission or the State Commission or the National Commission, as the case may be, shall record settlement of the issues which have been so settled and continue to hear other issues involved in such consumer dispute.

Where the consumer dispute could not be settled by mediation, the District Commission or the State Commission or the National Commission, as the case may be, shall continue to hear all the issues involved in such consumer dispute.

## PRODUCT LIABILITY

Chapter VI contains Section 82 to 87 deal with Product Liability. According to section 82 Chapter VI shall apply to every claim for compensation under a product liability action by a complainant for any harm caused by a defective product manufactured by a product manufacturer or serviced by a product service provider or sold by a product seller.

### Product Liability Action

According to Section 83 of the Act, a product liability action may be brought by a complainant against a **product manufacturer or a product service provider or a product seller**, as the case may be, for any harm caused to him on account of a defective product.

### Liability of Product Manufacturer

Section 84 states that a product manufacturer shall be liable in a product liability action, if-

- the product contains a manufacturing defect; or
- the product is defective in design; or
- there is a deviation from manufacturing specifications; or
- the product does not conform to the express warranty; or
- the product fails to contain adequate instructions of correct usage to prevent any harm or any warning regarding improper or incorrect usage.

A product manufacturer shall be liable in a product liability action even if he proves that he was not negligent or fraudulent in making the express warranty of a product.

### Liability of Product Service Provider

Section 85 provides that a product service provider shall be liable in a product liability action, if-

- the service provided by him was faulty or imperfect or deficient or inadequate in quality, nature or manner of performance which is required to be provided by or under any law for the time being in force, or pursuant to any contract or otherwise; or
- there was an act of omission or commission or negligence or conscious withholding any information which caused harm; or

- (c) the service provider did not issue adequate instructions or warnings to prevent any harm; or
- (d) the service did not conform to express warranty or the terms and conditions of the contract.

### Liability of Product Sellers

Section 86 states that a product seller who is not a product manufacturer shall be liable in a product liability action, if-

- (a) he has exercised substantial control over the designing, testing, manufacturing, packaging or labelling of a product that caused harm; or
- (b) he has altered or modified the product and such alteration or modification was the substantial factor in causing the harm; or
- (c) he has made an express warranty of a product independent of any express warranty made by a manufacturer and such product failed to conform to the express warranty made by the product seller which caused the harm; or
- (d) the product has been sold by him and the identity of product manufacturer of such product is not known, or if known, the service of notice or process or warrant cannot be effected on him or he is not subject to the law which is in force in India or the order, if any, passed or to be passed cannot be enforced against him; or
- (e) he failed to exercise reasonable care in assembling, inspecting or maintaining such product or he did not pass on the warnings or instructions of the product manufacturer regarding the dangers involved or proper usage of the product while selling such product and such failure was the proximate cause of the harm.

### Exceptions to Product Liability Action

According to Section 87 of the Act a product liability action cannot be brought against the product seller if, at the time of harm, the product was misused, altered, or modified.

In any product liability action based on the failure to provide adequate warnings or instructions, the product manufacturer shall not be liable, if-

- (a) the product was purchased by an employer for use at the workplace and the product manufacturer had provided warnings or instructions to such employer;
- (b) the product was sold as a component or material to be used in another product and necessary warnings or instructions were given by the product manufacturer to the purchaser of such component or material, but the harm was caused to the complainant by use of the end product in which such component or material was used;
- (c) the product was one which was legally meant to be used or dispensed only by or under the supervision of an expert or a class of experts and the product manufacturer had employed reasonable means to give the warnings or instructions for usage of such product to such expert or class of experts; or
- (d) the complainant, while using such product, was under the influence of alcohol or any prescription drug which had not been prescribed by a medical practitioner.

A product manufacturer shall not be liable for failure to instruct or warn about a danger which is obvious or commonly known to the user or consumer of such product or which, such user or consumer, ought to have known, taking into account the characteristics of such product.

### OFFENCES AND PENALTIES

#### Penalty for Noncompliance of Direction of Central Authority

Section 88 provides that whoever, fails to comply with any direction of the Central Authority under sections 20 and 21, shall be punished with imprisonment for a term which may extend to six months or with fine which may extend to twenty lakh rupees, or with both.

It may be noted that Sections 20 deals with power of Central Authority to recall goods, etc. and Sections 21 deals with power of Central Authority to issue directions and penalties against false or misleading advertisements.

### **Punishment for False or Misleading Advertisement**

Section 89 states that any manufacturer or service provider who causes a false or misleading advertisement to be made which is prejudicial to the interest of consumers shall be punished with imprisonment for a term which may extend to two years and with fine which may extend to ten lakh rupees; and for every subsequent offence, be punished with imprisonment for a term which may extend to five years and with fine which may extend to fifty lakh rupees.

### **Punishment for False or Misleading Advertisement**

Section 92 provides that no cognizance shall be taken by a competent court of any offence under sections 88 and 89 except on a complaint filed by the Central Authority or any officer authorised by it in this behalf.

### **Compounding of Offences**

According to Section 96(1) of the Act, any offence punishable under sections 88 and 89, may, either before or after the institution of the prosecution, be compounded, on payment of such amount as may be prescribed.

It may be noted that no compounding of such offence shall be made without the leave of the court before which a complaint has been filed under section 92.

Further, such sum shall not, in any case, exceed the maximum amount of the fine, which may be imposed under this Act for the offence so compounded.

Section 96(2) provides that the Central Authority or any officer as may be specially authorised by him in this behalf, may compound offences under sub-section (1).

Section 96(3) states that nothing in sub-section (1) shall apply to person who commits the same or similar offence, within a period of three years from the date on which the first offence, committed by him, was compounded.

Any second or subsequent offence committed after the expiry of a period of three years from the date on which the offence was previously compounded, shall be deemed to be a first offence.

Section 96(4) provides that where an offence has been compounded under sub-section (1), no proceeding or further proceeding, as the case may be, shall be taken against the offender in respect of the offence so compounded.

Section 96(5) states that the acceptance of the sum of money for compounding an offence in accordance with sub-section (1) by the Central Authority or an officer of the Central Authority empowered in this behalf shall be deemed to amount to an acquittal within the meaning of the Code of Criminal Procedure, 1973.

### **Punishment for Manufacturing for Sale or Storing, Selling or Distributing or Importing Products Containing Adulterant**

Section 90(1) provides that whoever, by himself or by any other person on his behalf, manufactures for sale or stores or sells or distributes or imports any product containing an adulterant shall be punished, if such act-

- (a) does not result in any injury to the consumer, with imprisonment for a term which may extend to six months and with fine which may extend to one lakh rupees;
- (b) causing injury not amounting to grievous hurt to the consumer, with imprisonment for a term which may extend to one year and with fine which may extend to three lakh rupees;
- (c) causing injury resulting in grievous hurt to the consumer, with imprisonment for a term which may extend to seven years and with fine which may extend to five lakh rupees; and
- (d) results in the death of a consumer, with imprisonment for a term which shall not be less than seven years, but which may extend to imprisonment for life and with fine which shall not be less than ten lakh rupees.

Section 90(2) states that the offences under clauses (c) and (d) of sub-section (1) shall be cognizable and non-bailable.

Notwithstanding the punishment under sub-section (1), the court may, in case of first conviction, suspend any licence issued to the person referred to in that sub-section, under any law for the time being in force, for a period up to two years, and in case of second or subsequent conviction, cancel the licence.

**Explanation.-**for the purposes of this section,-

- (a) "Adulterant" means any material including extraneous matter which is employed or used for making a product unsafe;
- (b) "Grievous hurt" shall have the same meaning as assigned to it in section 320 of the Indian Penal Code.

### **Punishment for Manufacturing for Sale or for Storing or Selling or Distributing or Importing Spurious Goods**

Section 91(1) provides that whoever, by himself or by any other person on his behalf, manufactures for sale or stores or sells or distributes or imports any spurious goods shall be punished, if such act-

- (a) causing injury not amounting to grievous hurt to the consumer, with imprisonment for a term which may extend to one year and with fine which may extend to three lakh rupees;
- (b) causing injury resulting in grievous hurt to the consumer, with imprisonment for a term which may extend to seven years and with fine which may extend to five lakh rupees;
- (c) results in the death of a consumer, with imprisonment for a term which shall not be less than seven years, but may extend to imprisonment for life and with fine which shall not be less than ten lakh rupees.

Section 91(2) states that the offences under clauses (b) and (c) of sub-section (1) shall be cognizable and non-bailable.

Notwithstanding the punishment under sub-section (1), the court may, in case of first conviction, suspend any licence issued to the person referred to in that sub-section, under any law for the time being in force, for a period up to two years, and in case of second or subsequent conviction, cancel the licence.

### **Measures to Prevent Unfair Trade Practices in E-Commerce, Direct Selling**

Section 94 empowers the Central Government to take such measures in the prescribed manner for the purposes of preventing unfair trade practices in e-commerce, direct selling and also to protect the interest and rights of consumers.

### **Protection of Action Taken in Good Faith**

According to Section 98 of the Act, no suit, prosecution or other legal proceeding shall lie against the Presidents and members of the District Commission, the State Commission and the National Commission, the Chief Commissioner, the Commissioner, any officer or employee and other person performing any duty under this Act, for any act which is in good faith done or intended to be done in pursuance of this Act or under any rule or order made thereunder.

### **Act not in derogation of any other law**

Section 100 states that the provisions of Consumer Protection Act, 2019 shall be in addition to and not in derogation of the provisions of any other law for the time being in force.

## LESSON ROUND-UP

- Consumer Protection Act, 2019 provides for protection of the interests of consumers and for the said purpose, to establish authorities for timely and effective administration and settlement of consumers' disputes and for matters connected therewith or incidental thereto.
- Consumer means any person who (i) buys any goods for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any user of such goods other than the person who buys such goods for consideration paid or promised or partly paid or partly promised, or under any system of deferred payment, when such use is made with the approval of such person, but does not include a person who obtains such goods for resale or for any commercial purpose; or (ii) hires or avails of any service for a consideration which has been paid or promised or partly paid and partly promised, or under any system of deferred payment and includes any beneficiary of such service other than the person who hires or avails of the services for consideration paid or promised, or partly paid and partly promised, or under any system of deferred payment, when such services are availed of with the approval of the first mentioned person, but does not include a person who avails of such service for any commercial purpose.
- The expression "commercial purpose" does not include use by a person of goods bought and used by him exclusively for the purpose of earning his livelihood, by means of self-employment and the expressions "buys any goods" and "hires or avails any services" includes offline or online transactions through electronic means or by teleshopping or direct selling or multi-level marketing.
- Direct selling means marketing, distribution and sale of goods or provision of services through a network of sellers, other than through a permanent retail location.
- E-Commerce means buying or selling of goods or services including digital products over digital or electronic network.
- Electronic service provider means a person who provides technologies or processes to enable a product seller to engage in advertising or selling goods or services to a consumer and includes any online market place or online auction sites.
- Endorsement in relation to an advertisement, means any message, verbal statement, demonstration; or depiction of the name, signature, likeness or other identifiable personal characteristics of an individual; or depiction of the name or seal of any institution or organisation, which makes the consumer to believe that it reflects the opinion, finding or experience of the person making such endorsement.
- Express warranty means any material statement, affirmation of fact, promise or description relating to a product or service warranting that it conforms to such material statement, affirmation, promise or description and includes any sample or model of a product warranting that the whole of such product conforms to such sample or model.
- Product liability means the responsibility of a product manufacturer or product seller, of any product or service, to compensate for any harm caused to a consumer by such defective product manufactured or sold or by deficiency in services relating thereto.
- Section 10 empowers the Central Government to establish a Central Consumer Protection Authority to be known as the Central Authority to regulate matters relating to violation of rights of consumers, unfair trade practices and false or misleading advertisements which are prejudicial to the interests of public and consumers and to promote, protect and enforce the rights of consumers as a class.
- District Commission shall have jurisdiction to entertain complaints where the value of the goods or services paid as consideration does not exceed one crore rupees.
- State Commission shall have jurisdiction to entertain complaints where the value of the goods or services paid as consideration, exceeds rupees one crore, but does not exceed rupees ten crore.

- National Commission shall have jurisdiction to entertain Complaints where the value of the goods or services paid as consideration exceeds rupees ten crore.
- Product liability action may be brought by a complainant against a product manufacturer or a product service provider or a product seller, as the case may be, for any harm caused to him on account of a defective product.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Discuss in detail the objects of Consumer Protection Act, 2019.
2. Briefly discuss the jurisdiction of the various District, State and National Commissions under the Consumer Protection Act, 2019?
3. Discuss the power of Central Consumer Protection Authority?
4. Write short note on the following:
  - (i) Express Warranty
  - (ii) Product Liability
  - (iv) Consumer.
5. Discuss unfair trade practice under Consumer Protection Act, 2019.

# Essential Commodities Act, 1955

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## ***Key Concepts One Should Know***

- Essential Commodities
- Seizure
- Confiscation

## ***Learning Objectives***

### **To understand:**

- Essential Commodities
- Powers of Central Government
- Authorities responsible to administer the Act
- Seizure and Confiscation of Essential Commodities
- Offences by Companies

## ***Regulatory Framework***

- Essential Commodities Act, 1955

## ***Lesson Outline***

- Object and Scope of the Act
- Essential Commodities
- Powers of Central Government to Control Production, Supply and Distribution etc., of Essential Commodities
- Fixing of price for Essential Commodities
- Seizure of Essential Commodities
- Confiscation of Essential Commodities
- Appeal against Confiscation
- Orders Passed under Essential Commodities Act, 1955
- Offences and Penalties
- Grant of Injunction by Civil Court
- Culpable Mental State
- Offences by Companies
- Publication of names of Convicted Companies
- Attempt and Abetment
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

In 1939 the Government of India made certain rules to control the production, supply and distribution of certain commodities under the Defence of India Act which ceased to have force in September, 1946. It was however considered necessary that control in respect of certain commodities essential for human beings should continue in the interest of the general public. Therefore, the Essential Supplies (Temporary Powers) Ordinance, XVIII of 1946 was promulgated by which certain provisions of the Defence of India Rules continued to have force. This Ordinance was subsequently replaced by the Essential Supplies (Temporary Powers) Act, 1946 (Act No. XXIV of 1946).

The operation of the Act was prolonged upto 1st April, 1948, by virtue of a Notification published in the Gazette of India, dated March 8, 1947. Under certain resolution of the Constituent Assembly passed in 1948 and 1949 and by the Adaptation of Laws Act, 1950, the operation of the Act was further extended to different periods from time to time.

Since in public interest it was considered necessary that the Centre should continue to control production, supply and distribution of certain essential commodities, the need for a permanent measure on the subject was felt. For this purpose, certain amendments were required to be made in the Constitution. The Constitution (Third Amendment) Act made the required amendments in Entry 33 of List 3 of the Seventh Schedule to the Constitution to enable the Parliament to enact the required legislation. The Essential Commodities Ordinance No. 1 of 1955, was therefore, promulgated which came into force on 26th January, 1955. This Ordinance was subsequently replaced by the present Act namely, the Essential Commodities Act, 1955 (Act No. 1 of 1955) w.e.f 1st April, 1955.

## OBJECT AND SCOPE OF THE ACT



The Preamble to the Act says that it is an Act to provide in the interest of the general public for the control of the production, supply and distribution of, and trade and commerce in, certain commodities. The dominant object and intendment of the Act is to secure equitable distribution and availability at fair prices of essential commodities in the interest of the general public. The interest of the general public necessarily connotes the interest of the consuming public and not the interest of the dealer (1958 Andh. LT587).

## DEFINITIONS (SECTION 2)

The Act contains definitions of five important terms, namely:

### Collector

“Collector” includes an Additional Collector, and such other officer not below the rank of Sub-Divisional Officer as may be authorised to perform the functions and exercise the powers of the Collector under the Act [Section 2(ia)].

### Essential Commodities

Section 2A dealing with Essential commodities declaration, etc. defines the “essential commodity” as to mean a commodity specified in the Schedule.

#### *Schedule to the Act lists out following commodities:*

- (1) drugs: The explanation clarifies that for the purposes of this Schedule, “drugs” has the meaning assigned to it in clause (b) of Section 3 of the Drugs and Cosmetics Act, 1940;
- (2) fertilizer, whether inorganic, organic or mixed;
- (3) foodstuffs, including edible oilseeds and oils;
- (4) hank yarn made wholly from cotton;
- (5) petroleum and petroleum products;
- (6) raw jute and jute textiles;
- (7) (i) seeds of food-crops and seeds of fruits and vegetables;  
 (ii) seeds of cattle fodder; and  
 (iii) jute seeds.

Sub-section (2) empowers the Central Government to amend, if it is satisfied that it is necessary so to do in the public interest and for reasons to be specified in the notification published in the Official Gazette, the Schedule so as to (a) add a commodity to the said Schedule; and (b) remove any commodity from the said Schedule, in consultation with the State Governments.

In terms of Sub-section (3) any notification issued under Sub-section (2) may also direct that an entry shall be made against such commodity in the said Schedule declaring that such commodity shall be deemed to be an essential commodity for such period not exceeding six months to be specified in the notification. However, Central Government may, in the public interest and for reasons to be specified, by notification in the Official Gazette, extend such period beyond the said six months.

The Central Government may exercise its powers under Sub-section (2) in respect of the commodity to which Parliament has power to make laws by virtue of Entry 33 in List III in the Seventh Schedule to the Constitution. Every notification issued under sub-section (2) is required to be laid, as soon as may be after it is issued, before both Houses of Parliament.

In addition to the items included in the list given in the said clause, such other items which may be so declared by the Central Government by notified orders would also be included in the list of essential commodities, but in any case, such commodities would not be outside the scope of Entry 33 in List III in the Seventh Schedule to the Constitution. The Central Government has time and again, notified various commodities to be essential commodities. The term 'essential commodities' is defined in Rule 35(3) of the Defence of India Rules, 1962, to mean "food, water, fuel, light, power or any other thing notified by the Central Government in this behalf as essential for the existence of the community". Of course, the definition in the Essential Commodities Act is more comprehensive than that in the Defence of India Rules, but both definitions enumerate certain things or articles and have scope for addition to the list of other articles notified in that behalf by the Central Government. As such, the articles not expressly mentioned in the definition given in the Defence of India Rules, can become essential commodities within the meaning of the expression used in the Rules by a simple government notification and the slight difference in the definition of essential commodity in the Act from that given in the Rules does not make one repugnant to the other [*Nathuni Lai Gupta vs. The State (1964 Cr. LJ 662)*].



*IN S. Samuel, MD. Harrisons Malayava v. Union of India, AIR 2004 SC 218, Supreme Court held that Tea is not foodstuff. Even in a wider sense, foodstuffs will not include tea as tea either in the form of the leaves or in the form of beverage, does not go into the preparation of food proper to make it more palatable and digestible.*

*Tea leaves are not eaten. Tea is a beverage produced by steeping tea leaves or buds of the tea plants in the boiled water. Such tea is consumed hot or cold for its flavour, taste and its quality as a stimulant. The stimulating effect is caused by the presence of caffeine therein. Tea neither nourishes the body nor sustains nor promotes its growth. It does not have any nutritional value. It does not help formation of enzymes nor does it enable anabolism. Tea or its beverage does not go into the preparation of any foodstuff. In common parlance, any one who has taken tea would not say that he has taken or eaten food. Thus tea is not a food.*

**Order:** "Order" includes a direction issued thereunder [Section 2(c)].

**State Government:** "State Government", in relation to a Union territory means the administrator of such territory [Section 2(d)].

**Sugar:** "Sugar" means: (i) any form of sugar containing more than 90 per cent of sucrose, including sugar candy; (ii) Khangsari sugar or bura sugar or crushed sugar, or any sugar in crystalline or powdered form; or (iii) sugar in process in vacuum pan sugar factory, or raw sugar [Section 2(e)].

## Authorities responsible to administer the Act

Necessary powers have been given to the Central Government under the Act to administer the provisions of the Act by issuing orders/directions notified in the official gazette and by delegating the authority to State Governments and administrators of Union Territories. The Central Government at its apex level is responsible for achieving the objectives enshrined by the Parliament under this Act for the welfare and general well-being of all the citizens.

Powers of Central Government to control production, supply and distribution etc., of essential commodities [Section 3]



### Power to Issue Orders

The Central Government having been vested with power under Section 3(1) can issue order in the following circumstances providing for regulating or prohibiting the production, supply and distribution of essential commodities and trade and commerce therein:

- (i) when it is necessary or expedient for maintaining or increasing supplies of any essential commodity;
- (ii) for securing the equitable distribution and availability of essential commodities at fair price; or
- (iii) for securing any essential commodity for the defence of India or the efficient conduct of military operations.

Section 3(1A) provides that notwithstanding anything contained in sub-section (1),—

- (a) the supply of such foodstuffs, including cereals, pulses, potato, onions, edible oilseeds and oils, as the Central Government may, by notification in the Official Gazette, specify, may be regulated only under extraordinary circumstances which may include war, famine, extraordinary price rise and natural calamity of grave nature;
- (b) any action on imposing stock limit shall be based on price rise and an order for regulating stock limit of any agricultural produce may be issued under this Act only if there is—
  - (i) hundred per cent. increase in the retail price of horticultural produce; or
  - (ii) fifty per cent. increase in the retail price of non-perishable agricultural food stuffs, over the price prevailing immediately preceding twelve months, or average retail price of last five years, whichever is lower:

Provided that such order for regulating stock limit shall not apply to a processor or value chain participant of any agricultural produce, if the stock limit of such person does not exceed the overall ceiling of installed capacity of processing, or the demand for export in case of an exporter:

Provided further that nothing contained in this sub-section shall apply to any order, relating to the Public Distribution System or the Targeted Public Distribution System, made by the Government under this Act or under any other law for the time being in force.

*Explanation.*—The expression “value chain participant”, in relation to any agricultural product, means and includes a set of participants, from production of any agricultural produce in the field to final consumption, involving processing, packaging, storage, transport and distribution, where at each stage value is added to the product.

## Contents of the Order

Notwithstanding the above and without prejudice to the generality of the powers contained in Sub-section above, Sub-section (2) of Section 3 provides that the Central Government may issue an order which may provide for all or any of the following matters:

- (a) for regulating by licences, permits or otherwise the production or manufacture of any essential commodity;
- (b) for bringing under cultivation any waste or arable land, whether appurtenant to a building or not, for growing thereon of food crops generally or of specified food crops and for otherwise maintaining or increasing the cultivation of food crops generally, or of specified foodcrops;

- (c) for controlling the price at which any essential commodity may be bought or sold.
- (d) for regulating by licences, permits or otherwise the storage, transport, distribution, disposal, acquisition, use or consumption of any essential commodity;
- (e) for prohibiting the withholding from sale of any essential commodity ordinarily kept for sale;
- (f) for requiring any person holding in stock, or engaged in the production, or in the business of buying or selling, of any essential commodity—(a) to sell the whole or a specified part of the quantity held in stock or produced or received by him, or (b) in the case of any such commodity which is likely to be produced or received by him, to sell the whole or a specified part of such commodity when produced or received by him, to the Central Government or a State Government or to an officer or agent of such Government or to a Corporation owned or controlled by such Government or to such other person or class of persons and in such circumstances as may be specified in the order.

Explanation I provides that an order made under this clause in relation to foodgrains, edible oilseeds or edible oils may, having regard to the estimated production, in the concerned area, of such foodgrains, edible oilseeds and edible oils, fix the quantity to be sold by the producers in such area and may also fix, or provide for the fixation of such quantity on a graded basis, having regard to the aggregate of the area held by, or under the cultivation of the producers.

Explanation II provides that “production” for the purposes of this clause includes manufacture of edible oils and sugar with its grammatical variation and cognate expressions;

- (g) for regulating or prohibiting any class of commercial or financial transactions relating to foodstuffs which in the opinion of the authority making the order, are, or if unregulated, are likely to be detrimental to the public interest;
- (h) for collecting any information or statistics with a view to regulating or prohibiting any of the aforesaid matters;
- (i) for requiring persons engaged in the production of, or trade and commerce in, any essential commodity to maintain and produce for inspection such books, accounts and record relating to their business and to furnish such information relating thereto as may be specified in the order;
- (j) for the grant or issue of licences, permits or other documents, the charging of fees therefor, the deposit of such sum, if any, as may be specified in the order as security for the due performance of the conditions of any such licence, permit or other document, the forfeiture of the sum so deposited or any part thereof for contravention of any such conditions and the adjudication of such forfeiture by such authority as may be specified in the order;
- (k) for any incidental and supplementary matters, including in particular, the entry, search or examination of premises, aircraft, vessels, vehicles or other conveyances and animals and the seizure by a person authorised to make such entry, search or examination of any article in respect of which such person has reason to believe that a contravention of the order has been, is being or is about to be, committed and any packages, coverings, or receptacles in which such articles are found; (ii) of any aircraft, vessel, vehicle or other conveyance or animal used in carrying such articles, if such a person has reason to believe that such aircraft, vessel, vehicle or other conveyance or animal is liable to be forfeited under the provisions of this Act; (iii) of any books of account and documents which in the opinion of such person, may be useful to, or relevant to any proceeding under this Act and the person from whose custody such books of account or documents are seized shall be entitled to make copies thereof or to take extracts therefrom in the presence of an officer having the custody of such books of account or documents.

### Fixing the Price of Essential Commodities being sold to Government

Section 3(3) vests powers in Central Government to deal with the pricing of the essential commodities particularly when the commodities are being sold to Central/State Government in compliance of order under clause (f) of Sub-section (2) of Section 3. In such a case, the price shall be paid as provided hereunder:

- (a) the agreed price, where the price can be agreed upon consistently with the controlled price fixed under this section;
- (b) controlled price: where no such agreement can be reached, the price calculated with reference to controlled price;

- (c) the price calculated at the market rate prevailing in the locality on the date of sale, where neither clause nor clause (b) applies.

### Fixing the Price of Essential commodities during Emergency

Section 3(3A)(i) is in the nature of an emergency provision and can be resorted to meet a situation arising at a particular locality. It empowers the Central Government to direct the price at which the foodstuffs in any locality will be sold to general public. This direction will be issued only when the Central Government is of the opinion that taking such step is necessary for controlling price rise or preventing the hoarding of any foodstuff in any locality. The notification issued by the Government to the above effect shall be in force for 3 months only as may be specified therein as per Sub-section (3A)(ii). Further, for selling specified foodstuffs in the specified locality, the seller shall be paid price therefor as follows:

- (a) agreed price, when the price can be agreed upon consistently with the controlled price fixed under this sub-section; or
- (b) the controlled price, when no such agreement can be reached as stated above; or
- (c) the market rate price as per the prevailing market rate in the locality at the date of sale where neither of the above clause (a) or (b) apply.

### Payment of Procurement Price for Foodgrains and Edible Oil

The Essential Commodities (Amendment) Act, 1976, inserted Sub-section (3B) in substitution of the then existing section providing for payment of procurement price of such foodgrains, edible oils or oilseeds as may be specified by State Government with the prior approval of Central Government. Therefore, as per Section 3(3B) where any person is required in terms of an order under Sub-section (2)(f) to sell to the Central Government or a State Government or any officer or agent of such Government or to a Corporation owned or controlled by such Government any grade or variety of foodgrains, edible oil and oilseeds in relation to which no notification has been issued Under Section 3(3A) or such notification, having been issued, has ceased to be in force, procurement price shall be paid irrespective of the provisions of Sub-section (3) having regard to the following facts:

- (a) the controlled price, if any, fixed under this section or by or under any other law for the time being in force for such grade or variety of foodgrains, edible oils and oilseeds;
- (b) the general crop prospects;
- (c) the need for making such grade or variety of foodgrains, edible oils and seeds available at reasonable prices to the consumers, particularly the vulnerable sections of the consumers; and
- (d) the recommendations, if any, of the Agricultural Prices Commission with regard to the price of the concerned grade or variety of foodgrains, edible oils and oilseeds.

### Fixing Price for Sugar to be Paid to Producer

Sub-section (3C) of Section 3 provides that where any producer of sugar is required by an order made under Sub-section (2)(f) to sell any kind of sugar to the Central or State Government/officer or agent of such government or to any person/class of persons, whether notification in this regard under Sub-section (3A) is issued or not or ceased to be in force and notwithstanding anything contained in Sub-section (3), the producer shall be paid such price for sugar as the Central Government may, by order, determine having regard to (a) the minimum price, if any fixed for sugar cane by the Central Government under this section; (b) the manufacturing cost of sugar; (c) the duty or tax, if any, paid or payable thereon; and (d) the securing of a reasonable return on the capital employed in the business of manufacturing sugar.

Further, the Central Government may determine different prices for different areas from time to time or for different factories or for different kinds of sugar. It is explained in the sub-section that producers for the purposes of this sub-section shall include persons carrying on business of manufacturing sugar.

Price fixation under Section 3(2) and 3(3B) is different from price fixation in the case of sugar under Sub-section (3C). In the former, the dominant purpose in fixing price is to ensure that goods are available to consumers at a reasonable price. In the latter, price fixed must also give a reasonable return on investment to the producer.

Sub-section (3D) of the Act empowers the Central Government to direct that no producer, importer or exporter to sell or otherwise dispose of or deliver any kind of sugar or remove any kind of sugar from the bonded godowns of the factory in which it is produced, whether such godowns are situated within the premises of the factory or outside or from the warehouses of the importers or exporters, as the case may be, except under and in accordance with its direction. However, this provision does not affect the pledging of such sugar by any producer or importer in favour of any scheduled bank as defined in clause (e) of Section 2 of the Reserve Bank of India Act, 1934 or any corresponding new bank constituted under section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, so, however, that no such bank sells the sugar pledged to it except under and in accordance with a direction issued by the Central Government.

In terms of Sub-section 3(E) the Central Government has been empowered to direct from time to time, by general or special order, any producer or importer or exporter or recognised dealer or any class of producers or recognised dealers, to take action regarding production, maintenance of stocks, storage, sale, grading, packing, marking, weighment, disposal, delivery and distribution of any kind of sugar in the manner specified in the direction.

### **Power to Appoint Authorised Controller**

The Central Government has been vested with necessary powers under Sub-section (4) of Section 3 to authorise any person (known as authorised controller) when it is considered necessary for maintaining or increasing the production and supply of essential commodities. The authorised controller shall exercise such functions of control as may be provided in the order with respect to the whole or any part of any such undertaking engaged in the production and supply of the commodity. The authorised controller shall exercise his functions in accordance with any instructions given to him by the Central Government. He shall not have any power to give any direction inconsistent with the provisions of any enactment or any instrument determining the functions of the person in charge of the management of the undertaking except in so far as may be specifically provided by the order. The undertaking shall be carried on in accordance with any directions, given by the authorised controller under the provisions of the order. The person who is responsible to function as a manager of the undertaking or part of it shall comply with such directions.

### **Issuance and Service of Order**

An order made under Section 3 of the Act shall be issued and served in the manner as provided under Section 3(5) i.e. in the following manner:

- (a) in the case of an order of general nature or affecting a class of persons be notified in the official gazette; and
- (b) in the case of an order directed to a specified individual be served on such individual (i) by delivering or tendering it to that individual, or (ii) if it cannot be so delivered or tendered, by affixing it on the outer door or some other conspicuous part of the premises in which that individual lives, and a written report thereof shall be prepared and witnessed by two persons living in the neighbourhood.

### **Laying the Order before Parliament**

Sub-section (6) provides that every order made under Section 3 by the Central Government or by any officer or authority of Central Government shall be laid before both Houses of Parliament as soon as may be, after it is made.

### **Imposition of Duties on State Government**

Section 4 of the Act provides that an order made under Section 3 may confer powers and impose duties upon the Central Government or the State Government or officers and authorities of the Central Government or State Government and may contain directions to any, State Government or to officers or authorities thereof as to the exercise of any such powers or discharge of any such duties.

### **Delegation of powers**

In terms of Section 5, the Central Government may, by notified order direct that the power to make orders or issue notifications under Section 3 shall in relation to such matters and subject to such conditions, if any, as may be

specified in the direction be exercisable also by (a) such officer or authority subordinate to Central Government, (b) such State Government or such officer or authority subordinate to a State Government as may be specified in the direction.

## NATURE OF ORDER PASSED UNDER THE ACT

It may be noted from the foregoing paragraphs that the order notified by the Government under Section 3(2) specifies the various aspects which may be covered under the order while ensuring the production, procurement and distribution of the essential commodities. Further, Sub-sections (3), (3A), (3B), (3C) provide for issuance of order for fixation of prices of the essential commodities. Order may be passed for appointing Controlling Authority under this Act which is of different nature being administrative in kind and effect. Sub-section (5) provides for the issuance and service of the order. The order notified by the Government is such an important document that the Act provides, under Sub-section (6) of Section 3, for it to be placed before both Houses of Parliament. Thus, the order in its nature, is a medium of administering the Act and a proper course of communication to and from the Government, exercising and delegating the powers vested in the Government under the Act.

### Effect of the Order

Section 6 provides that the order made under Section 3 shall have effect notwithstanding anything inconsistent therewith contained in any enactment other than this Act or any instrument having effect by virtue of any enactment other than this Act.

It could be seen that this section does not either expressly or by implication, repeal any of the provisions of the pre-existing laws, nor does it abrogate such laws. The object of Section 6 is simply to bypass them. Thus, for example, an order made under Section 3 would be operative in regard to the essential commodities covered by the Textile Control Order, wherever there is any repugnancy in that order with any existing law and to that extent the existing law with regard to those commodities will not operate.

The Calcutta High Court had observed that the ultimate effect of Section 6 is that an order under Section 3 will override existing laws, only on the ground that these are orders validly made under Section 3 of the Act (*Ramananda Agrawala v. State AIR 1951 Calcutta 120*).

As rightly pointed out by the Patna High Court, Section 6 is a saving section which affords protection to the orders made under Section 3 of the Act as against the onslaught of any law, merely by reason of inconsistency (*Mohammad Anwar Hussi v. State of Bihar, AIR 1955 Patna 220*).

### Presumption as to Orders

Section 13 provides that where an order purports to have been made and signed by an authority in exercise of any powers conferred by or under this Act, a court so presume that such order was so made by that authority within the meaning of Indian Evidence Act, 1972.

### Burden of Proof in certain cases

Section 14 provides that on being prosecuted for contravention of any order made under Section 3 which prohibits him from doing any act or being in possession of a thing without lawful authority or without a permit, licence or other document such person shall have to prove that he has such authority, permit, licence or other document as the burden of proof lies upon him.

### Protection for Acts done in Pursuance of Order

Section 15 provides immunity against action taken in good faith under the Act and lays down that no suit, prosecution or other legal proceedings can be taken against any person for anything which is in good faith done, or intended to be done, in pursuance of any order made under Section 3 of the Act. Likewise, no suit or other legal proceedings can lie against the Government, for any damage caused or likely to be caused, by any thing which is in good faith done, or intended to be done, in pursuance of any order made under Section 3 of the Act.

It may be noted that immunity can be claimed by the Government or by its officers, only if it is shown that an order was issued under Section 3 of the Act, and the liability which the plaintiff is seeking to enforce arises from the fact that action was taken in pursuance of the order of the government under that section.

## CONFISCATION OF ESSENTIAL COMMODITIES

### Seizure and Confiscation of Essential Commodities

The Essential Commodities Act envisages two independent proceedings against a person charged with contravention of the provisions of the Act. Under Section 6A, the Collector can confiscate the seized commodity and under Section 7, the contravention would be punishable. Confiscation of essential commodities is a sharp weapon which the Act has provided to the Central Government under Section 6A of the Act.

Section 6A provides that where any essential commodity is seized in pursuance of an order made under Section 3, a report of such seizure shall be made, without any unreasonable delay, to the Collector of the district or the Presidency town in which such essential commodity is seized. The Collector at his discretion, may direct for the production of the seized commodity before him and if he is satisfied that there has been contravention of the order he may pass order for confiscation of (a) the essential commodity so seized, (b) any package, covering or receptacle in which such essential commodity is found, and (c) any animal, vehicle, vessel or other conveyance used in carrying such essential commodity. Provided that without prejudice to any action which may be taken under any other provision of this Act, no foodgrains or edible oilseeds seized in pursuance of an order made under Section 3 in relation thereto from a producer shall, if the seized foodgrains or edible oilseeds have been produced by him, be confiscated under this section. Provided further that in the case of any animal, vehicle, vessel or other conveyance the owner of such animal, vehicle etc., shall be given an option to pay in lieu of its confiscation, a fine not exceeding the market price at the date of seizure of the essential commodity sought to be carried by such animal, vehicle, vessel, or other conveyance.

The Act uses the expressions 'confiscation' and 'seizure' in Section 6A and under this section a commodity which has been seized in pursuance of an order under Section 3 can be confiscated under the circumstances mentioned in Section 6A. Therefore, it is essential to know in brief the distinction between seizure and confiscation.

#### 'Seizure'

*The expression 'seize' means to take possession contrary to the wishes of the owner of the property and that such action is unilateral action of the person seizing. The person from whom anything is seized loses, from the moment of seizure, the right or power to control or regulate the use of that thing. The dictionary meaning of the word 'seize' means to lay hold of suddenly or forcible, to take hold of, to reach and grasp, to clutch. It also means to take possession of or appropriate in order to subject to the force or operation of a warrant, order of Court or other legal processes. A reference to some provisions of the Codes of Criminal Procedure shows that the term seizure had been used therein in connection with the taking of actual physical possession of moveable property.*

#### 'Confiscation'

*'Confiscation' according to Wharton's Law Lexicon, is condemnation and adjudication of property to the public treasury as of goods seized under the Customs Act. Confiscation, according to Stroud's Judicial Dictionary, must be an act done in some way on the part of the Government of the country where it takes place and in some way beneficial to that Government, though the proceeds may not strictly speaking be brought into its treasury. In State of Kerala v. Mathai (1961 K.L.T. 169) it was pointed out that confiscation is not to be considered part of the sentence for an offence but is only a mode by which Courts can dispose of property which comes before it in criminal trials.*

That being the general distinction between confiscation and seizure, in the context of the Essential Commodities Act, it could be seen that an essential commodity which has been seized, could be confiscated. Therefore, confiscation is an action posterior to the seizure of the essential commodity. A commodity that has not been seized cannot be confiscated. Seizure itself does not imply confiscation. The seizure should have been made by virtue of an order passed under Section 3 of the Act. Clause (j) of Section 3 empowers the Government to make an order for seizure of

any essential commodity if an order made by the Central Government controlling production, supply, distribution etc. of essential commodities has been or is about to be contravened. Therefore, any contravention or intended contravention of an order passed by the Government under the Act may lead to seizure, and under the circumstances mentioned in Section 6A such seized commodity could be confiscated.

Power is conferred on the Collector to confiscate any animal, vehicle, vessel or other conveyance if used in carrying the essential commodities. Where it was clear from the report of the Sub-Inspector of Police that the jeep in question was not found or used for carrying any essential commodity, it was found moving in front of the lorry which was loaded with paddy, it was held that, that by itself was no ground for its seizure. Unless the vehicle was used for carrying the essential commodities, the Deputy Commissioner had no jurisdiction to initiate proceedings for its confiscation, much less the police to seize it. *[Ramchandra v. Sub-Inspector of Police (1976) 1 Kar. L.J. 126]*

The Collector has no jurisdiction to go into the validity of the seizure; he could only confiscate goods, out of those seized, in respect of which contravention is established. Only if the seizure is valid could the Collector have jurisdiction to go on into the question whether there has been any contravention of the control order in respect of the whole or part of the goods, seized at this is entirely different from saying that the Collector could go on with the enquiry, postulated in Sections 6A and 6B, when the seizure itself, on which alone his jurisdiction to make an enquiry depends, is found to be illegal. *[Hindustan Aluminium v. Controller of Aluminium, AIR (1976) DeWii225]*

In *S. Seetharamayya Gupta v. Distt. Revenue Officer, Chittoor* (AIR 1977 AP 103) it was held that delegation of power of the Collector under Section 6A to Distt. Officer is competent and valid. Even though Section 6A authorizes confiscation of seized goods it does not say that the entire seized quantity should be directed to be confiscated. It is left to the discretion of the Distt. Revenue Officer land the appellate authority to decide whether the entire seized stock should be confiscated or only a portion of it. That, however, is a judicial discretion and must be exercised judicially having regard to the circumstances of the case, the gravity of the matter and other relevant and pertinent factors. The Act provides for enquiry and total absence of adequate opportunity to the party to make representation and consequently passing order of confiscation must be held bad.

### Sale of the Confiscated Commodity

Section 6A(2) provides that where the Collector, on receiving a report of seizure or on inspection of any essential commodity under Sub-section (1) above, is of the opinion that the essential commodity is subject to speedy and natural decay or it is otherwise expedient in the public interest so to do he may (i) order the same to be sold at the controlled price, if any, fixed for such essential commodity under this Act or under any other law for the time being in force; (ii) where no such price is fixed, order the same to be sold by public auction. Provided that in case of foodgrains, the collector may, for its equitable distribution and availability at fair prices, order the same to be sold through fair price shops at the price fixed by the Central Government or by the State Government as the case may be, for the retail sale of such foodgrains to the public.

### Disposal of Sale Proceeds of Confiscated Goods

In terms of Section 6A(3), the sale proceeds of the essential commodity sold, after deduction of the expenses of any such sale or auction or other incidental expenses relating thereto shall be paid to the owner or person from whom it is seized in the following circumstances: (a) where no order of confiscation is ultimately passed by the Collector; (b) where an order passed on appeal under Sub-section (1) of Section 6C so requires, or (c) where in a prosecution instituted for the contravention of the order in respect of which an order of confiscation has been made under this section, the person concerned is acquitted.

### Issue of Show Cause Notice before Confiscation of Essential Commodity

Before passing an order for confiscation under Section 6A, in terms of Sub-section (1) of Section 6B of the Act, the owner of the essential commodity, package, covering, receptacle, animal, vehicle, vessel or other conveyance or the person from whom it is seized is required to be given a notice in writing informing him of the grounds on which it is proposed to confiscate the above goods to provide him an opportunity of making a representation in writing within a reasonable time and give him a reasonable opportunity of being heard in the matter.

It is also provided in Sub-section (2) that no order of confiscation can be made if the owner of the confiscated animal, vehicle, vessel or other conveyance proves to the satisfaction of the Collector that the said modes of transport owned by him were used in carrying the essential commodity without his knowledge or connivance of himself or his agent, if any, and each of them had taken the necessary precautions against such use.

It is not sufficient for the owner to prove that the vehicle carried the essential commodity without his knowledge or concurrence. He must also prove that the vehicle was used without the knowledge, or concurrence of the person in charge of the vehicle. In addition, he must prove that not only he but also the person in charge of the vehicle had taken all reasonable and necessary precautions against such use [*Shai Rahhim v. State of Andhra* (1976) LT 357].

However, once an order confiscating the goods of above description has been passed it shall not be held invalid in terms of Sub-section (3) merely by reason of any defect or irregularity in the notice given under clause (a) of Sub-section (1) if in giving such notice the provisions of that clause have been substantially complied with.

### Appeal against Confiscation Order

In terms of Sub-section (1) of Section 6C, any person aggrieved by an order of confiscation under Section 6A may appeal to the State Government concerned within one month from the date of passing the order. The State Government shall give an opportunity to the appellant to be heard and pass such order as it may think fit, confirming, modifying or annulling the order appealed against. In terms of Sub-section (2) of Section 6C, if the appeal has been decided in favour of appellant, he is entitled to the possession of the confiscated goods and if it is not possible for any reason to return the essential commodity seized from him, such person shall be paid the price therefor as if the essential commodity had been sold to the Government with reasonable interest calculated from the day of seizure of essential commodity and such price shall be determined in accordance with: (i) Sub-section (3B) of Section 3 in case of foodgrains, edible oils and oilseeds; (ii) Sub-section (3C) of Section 3 in case of sugar; and (iii) Sub-section (3) of Section 3 in case of any other essential commodity.

### Confiscation and punishment

Section 6D provides that the award of any confiscation under this Act by the Collector shall not prevent the infliction of any punishment to which the person affected thereby is liable under this Act.

### Bar of Jurisdiction in Matters of Confiscation

The 1976 Amendment Act has inserted Section 6-E in the Act which provides that no court, tribunal or authority shall have any jurisdiction to make an order with regard to the matters falling within the purview of this Act particularly wherever any essential commodity is seized in pursuance of an order made under Section 3 when the Collector or the judicial authority appointed under Section 6C shall have the jurisdiction.

### OFFENCES AND PENALTIES

#### Cognizance of offences

Section 10A of the Act declares that notwithstanding anything contained in the Criminal Procedure Code, 1971, every offence punishable under the Act shall be cognizable.

A cognizable offence is one, where, under the Criminal Procedure Code or any other law in force, a police officer may arrest a person without a warrant.

Section 11 lays down that before a Court can take cognizance of any offence punishable under the Act, the following three conditions must be satisfied, viz. (i) there must be a report in writing, (ii) the report must be made by a public servant, as defined in Section 21 of Indian Penal Code, or any aggrieved person or any recognised consumer association.

### Prosecution of Public Servants (Section 15A)

If any public servant is accused of any offence alleged to have been committed by him while acting, or purporting to act, in the discharge of his duties, in pursuance of any order made under Section 3, no court can take cognizance of such an offence except with the previous sanction—(a) of the Central Government in the case of a person who is employed in connection with the affairs of the Union; and (b) of the State Government in the case of a person who is employed in connection with the affairs of the State.

### Penalties

Section 7 of the Act deals with penalties. Contravention of an order passed by the Central Government under Section 3 with reference to clause (h) or (i) of Sub-section (2) thereof is punishable with imprisonment for a term which may extend to one year and also with fine [Section 7(1)(a)(i)]. For the contravention of an order with reference to other clauses of Sub-section (2) of Section 3 the punishment is imprisonment for a term ranging from three months to seven years and in addition fine is also leviable.

Further if any person contravenes any order made under Section 3, any property in respect of which the order has been contravened shall be forfeited to the Government and any package, covering, receptacle in which the property is found and any animal, vehicle, vessel or other conveyance used in carrying the property, could also be forfeited if the court so orders.

If any person to whom a direction is given under Section 3(4) (b) fails to comply with it, he shall be punishable with imprisonment for a term which shall not be less than three months but which may extend to seven years and shall also be liable to fine.

If any person convicted of an offence under Section 7(1)(a)(ii) or 7(2) is again convicted of an offence under the same provision he shall be punishable with imprisonment for the second and for every subsequent offence for a term which shall not be less than six months but which may extend to seven years besides fine. For adequate and sufficient reasons the court can award imprisonment for a term less than six months. Where an offence is committed for a second time, besides the above punishment, the Court can also order that the person shall not carry on any business of that essential commodity for such period not being less than six months as may be specified by the Court.



#### *Mens rea (Sections 6A and 7)*

*In Nathulal v. State of Madhya Pradesh (AIR 1966 S.C. 43) it was held by the Supreme Court that mens rea or guilty mind is an ingredient of the offence punishable under Section 7 of the Essential Commodities Act, 1955 i.e., an intentional contravention of an order made under Section 3, is an essential ingredient of an offence under Section 7. In other words, if the dealer did believe bona fide that he could store the foodgrains for instance, without infringing any order under Section 3, there could be no contravention under Section 7.*

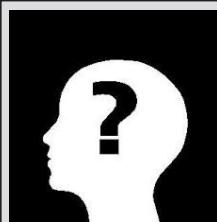
*It was observed by the Supreme Court in this case that mens rea is an essential ingredient of any criminal offence. Mens rea by necessary implication may be excluded from a statute only where it is absolutely clear that the implementation of the object of the Statute would otherwise be defeated. The nature of mens rea that would be implied in a Statute creating an offence depends on the object of the Act and the provisions thereof.*

*In Hariprasad Rao v. State (AIR 1951 SC 264), it was observed that unless a Statute either clearly or by necessary implication rules out mens rea as a constituent part of a crime, an accused cannot be found guilty of an offence against the criminal law unless he has got a guilty mind. Therefore, mens rea is an essential ingredient of an offence under Section 7 of the Act.*

It is to be noted that the contravention under Section 6A is also of the same character. Section 6A in brief provides for seizure and confiscation based on 'contravention' of an order under Section 3. Therefore, the Collector before exercising his powers under the section would be entitled to take into consideration the question whether there was an intentional contravention of the order or whether the conduct of the dealer was bona fide under the belief that he was acting legally. But it should be remembered that the orders of the Collector are provisional in the sense

that the Court is entitled, on appeal by the dealer, to look into whole matter to see whether there were reasons to confiscate the goods under Section 6A. It can be concluded that the provisions as regard 'contravention' under Section 6A or 7 are in *pari materia*—the contravention which details confiscation is of the same kind as that for which a dealer can be punished.

An interesting question is whether the doctrine of mens rea applies to cases of vicarious liability, as for instance, in the case of a master and servant. It is well accepted that the legislature cannot introduce the principles of vicarious liability and make the master liable for the act of his servants, although the master himself had no mens rea. Thus, in one case the charge against the respondents was that they sold some cloth in excess of the controlled price, and thus contravened the provisions of the Madhya Bharat Cotton Control Order; one of the respondents, Gangaram Saboo was not present in the shop at the time the cloth was alleged to have been sold, and it was, therefore, held that he could not be held vicariously liable for the act of his munim who had actually sold the cloth (*State v. Gangaram AIR 1935 H.B. 244*).



### Culpable Mental State

Section 10-C provides for a presumption of culpable mental state, which includes intention, motive, knowledge of a fact and the belief in a fact. It is now provided that in any prosecution for an offence under the Act which requires a culpable mental state on the part of the accused, the Court shall presume the existence of mental state. Of course, it is open to the accused to prove that he had no such mental state with respect of the act committed by him.

### Attempt and Abetment

Section 8 provides that any person who attempts to contravene or abets a contravention of any order made under Section 3 shall be deemed to have contravened that order.

### False Statement

A person shall be punishable under Section 9 with imprisonment for a term which may extend to five years or with fine or with both for the following offences:

- (i) when required by any order made under Section 3 to make any statement or furnish any information, makes any statement or furnishes any information which is false in any material particular which he knows or has reasonable cause to believe to be false or does not believe to be true, or
- (ii) makes any such statement as aforesaid in any book, account, record, declaration, return or other document which he is required by any such order to maintain or furnish.

### Offences by Companies

Section 10(1) provides that if the person contravening an order under Section 3 is, a company, every person who, at the time of the contravention, was in charge of, and was responsible to, the company for the conduct of the business of the company, shall be deemed to be guilty of the contravention, and shall be liable to be punished accordingly. In such cases, the company itself is also liable to be proceeded against. Any such person, can, however, escape liability if he proves that the contravention took place without his knowledge or that he exercised all due diligence to prevent it.

It may be noted that the term 'company' as used above, refers to any body corporate, and even includes a firm or other association or individuals. In the case of a firm, the term 'Director' would mean a partner in the firm.

### Publication of names of convicted companies by Court

Section 10-B of the Act provides that the Court may cause to be published in newspapers or in other manner at the expense of the company the name, place of business and the offence/contravention committed by it when a company has been convicted. However, no publication shall be made until the period for preferring an appeal against the order of the Court has expired, without any appeal having been preferred or where such appeal having been preferred, was disposed of. The expenses of any publication shall be recoverable from the company as if it were a fine imposed by Court.

## GRANT OF INJUNCTION BY CIVIL COURTS (SECTION 12B)

It is expressly provided by Section 12B that no Civil Court can grant any injunction or make any order for any other relief against the Central or State Government or any public officer, in respect of any act done, or purporting to be done, by such person in his official capacity under the Act, or any Order made thereunder, until after notice of the application for such injunction or other report is given to the Government or to such officer.

### LESSON ROUND-UP

- Essential Commodities Act, 1955 has been enacted to provide in the interest of the general public for the control of the production, supply and distribution of and trade and commerce in, certain commodities.
- Section 2A dealing with Essential commodities declaration, etc. defines the “essential commodity” as to means a commodity specified in the Schedule to the Act.
- Central Government has been empowered to administer the provisions of the Act by issuing orders/ directions notified in the official gazette and by delegating the authority to State Governments and administrators of Union Territories.
- An essential commodity which has been seized could be confiscated. Therefore, confiscation is an action posterior to the seizure of the essential commodity. A commodity that has not been seized cannot be confiscated. Seizure itself does not imply confiscation.
- Mens rea or guilty mind is an essential ingredient of the offence punishable under the Act.
- Culpable mental state, which includes intention, motive, knowledge of a fact and the belief in a fact.
- Where an offence is committed by a company, if it is proved that the offence had been committed with the consent or connivance of or is attributable to any neglect on the part of any Director, Manager, Secretary or other officer of the company, such a person shall be deemed to be guilty of that offence, and is liable to be proceeded against and punished accordingly.
- The Act expressly provides that no Civil Court can grant any injunction or make any order for any other relief against the Central or State Government or any public officer, in respect of any act done, or purporting to be done, by such person in his official capacity under the Act, or any Order made thereunder, until after notice of the application for such injunction or other report is given to the Government or to such officer.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

What do you understand by essential commodities? What are the commodities termed as essential commodities, under the Essential Commodities Act?

1. Specify the authority responsible for the administration and execution of the Act?
2. What do you know about an ‘order’ under the Act? What are the powers of Central Government in issuing the order under the Act?
3. There is difference in seizure and confiscation of commodities under the Act. How can the sale proceeds of confiscated commodities be utilized? What is the procedure for disposal of confiscated goods?
4. A reasonable opportunity is required to be given to the person concerned before confiscation of his commodities or vehicle etc., under the Act.
5. Elaborate this statement in the light of provisions of the Act.

## Lesson 15

# Legal Metrology Act, 2009

### ***Key Concepts One Should Know***

- Legal Metrology
- International Organization of Legal Metrology
- Pre-packed Commodity
- Counterfeit

### ***Learning Objectives***

#### **To understand:**

- Standard Weights and Measures
- Enforce Standards of Weights and Measures
- Power of Inspection, Seizure;
- Declarations on Pre-packaged Commodities
- Offences and Penalties

### ***Regulatory Framework***

- Legal Metrology Act, 2009
- Legal Metrology (Packaged Commodities) Rules, 2011

### ***Lesson Outline***

- Legal Metrology
- International Organisation of Legal Metrology
- Standard Weight and Measure
- Appointment and powers of Director and Legal Metrology Officer
- Verification and Stamping of Weight and Measure
- Maintain Records and Registers
- Pre-packed Commodities
- Declaration on Pre-packed Commodities
- Forfeiture
- Power of the Central Government to make Rules
- Power of the State Government to make Rules
- Compounding Offence
- Penalty for Counterfeiting
- Offences by Companies
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

Legal Metrology is the name by which the law relating to weights and measures is known in international parlance. Legal Metrology is very vital for scientific, technological and industrial progress of any country. The establishment of national standards of weights and measures and their proper enforcement aim at ensuring accuracy of measurements and measuring instruments and thus legal metrology strengthens the national economy in a broader sense besides being a potential instrument of consumer protection. The scope of legal metrology according to international practice extends to three broad fields of human activities, namely, commercial transactions, industrial measurements and measurements needed to ensure public health and human safety. The coverage of legal metrology varies from country to country. In some, almost all practical measurements are brought under the purview of legal metrology, whereas in other countries legal metrology finds restricted application in a few quantities like mass, length and volume used in trade and commerce. In most of the countries, however, legal metrology encompasses measurements which have a bearing on the protection of individuals from the financial and environmental points of view.

Legal metrology can be defined as that part of metrology which deals with units of measurement, methods of measurement and measuring instruments in so far as they concern statutory, technical and legal requirements which have the ultimate object of assuring public guarantee from the point of view of security and of appropriate accuracy of measurements.

## International Organization of Legal Metrology (OIML)

The International Organization of Legal Metrology (OIML) is an intergovernmental treaty organization whose membership includes Member States, countries which participate actively in technical activities, and Corresponding Members, countries which join the OIML as observers. It was established in 1955 in order to promote the global harmonization of legal metrology procedures. Since that time, the OIML has developed a worldwide technical structure that provides its Members with metrological guidelines for the elaboration of national and regional requirements concerning the manufacture and use of measuring instruments for legal metrology applications.

According to OIML, Legal Metrology is the entirety of the legislative, administrative and technical procedures established by, or by reference to public authorities, and implemented on their behalf in order to specify and to ensure, in a regulatory or contractual manner, the appropriate quality and credibility of measurements related to official controls, trade, health, safety and the environment.

The OIML develops model regulations, International Recommendations, which provide Members with an internationally agreed-upon basis for the establishment of national legislation on various categories of measuring instruments. Given the increasing national implementation of OIML guidelines, more and more manufacturers are referring to OIML International Recommendations to ensure that their products meet international specifications for metrological performance and testing.

## OIML Certificate System for Measuring Instruments

The OIML Certificate System for Measuring Instruments was introduced in 1991 to facilitate administrative procedures and lower the costs associated with the international trade of measuring instruments subject to legal requirements. The System provides the possibility for a manufacturer to obtain an OIML Certificate and a Test Report indicating that a given instrument type (pattern) complies with the requirements of the relevant OIML International Recommendations. Certificates are delivered by OIML Member States that have established one or several Issuing Authorities responsible for processing applications by manufacturers wishing to have their instrument types (patterns) certified.

Certificates issued by OIML are accepted by national metrology services on a voluntary basis, and as the climate for mutual confidence and recognition of test results develops between OIML Members, the System serves to simplify the type (pattern) approval process for manufacturers and metrology authorities by eliminating costly duplication of application and test procedures.

## DEFINITIONS

Section 2 contains definitions of various terms used in the Legal Metrology Act. Some of the important ones are reproduced hereunder.

### Dealer

According to section 2(b) Dealer in relation to any weight or measure, means a person who, carries on, directly or otherwise, the business of buying, selling, supplying or distributing any such weight or measure, whether for cash or for deferred payment or for commission, remuneration or other valuable consideration; and includes a commission agent, an importer, a manufacturer, who sells, supplies, distributes or otherwise delivers any weight or measure manufactured by him to any person other than a dealer;

### Export

According to section 2(d)"export" with its grammatical variations and cognate expressions, means taking out of India to a place 'outside India;

### Import

According section 2(e)"import" with its grammatical variations and cognate expressions, means bringing into India from a place outside India;

### Label

Under clause(j) of section 2"label" means any written, marked, stamped, printed or graphic matter affixed to, or appearing upon any pre-packaged commodity;

### Legal Metrology

As per section 2(g)"Legal Metrology" means that part of metrology which treats units of weighment and measurement, methods of weighment and measurement and weighing and measuring instruments, in relation to the mandatory technical and legal requirements which have the object of ensuring public guarantee from the point of view of security and accuracy of the weighments and measurements;

### Manufacture

As per section 2(i) "manufacturer" in relation to any weight or measure, means a person who -

- (i) manufactures weight or measure,
- (ii) manufactures one or more parts, and acquires other parts, of such weight or measure and, after assembling those parts, claims the end product to be a weight or measure manufactured by himself or itself, as the case may be,
- (iii) does not manufacture any part of such weight or measure but assembles parts thereof manufactured by others and claims the end product to be a weight or measure manufactured by himself or itself, as the case may be,
- (iv) puts, or causes to be put, his own mark on any complete weight or measure made or manufactured by any other person and claims such product to be a weight or measure made or manufactured by himself or itself, as the case may be;

### Protection

Section 2(k) define "protection" as to mean the utilisation of reading obtained from any weight or measure, for the purpose of determining any step which is required to be taken to safeguard the well-being of any human being or animal, or to protect any commodity, vegetation or thing, whether individually or collectively;

## Pre-packed Commodity

Section 2(l) define “pre-packaged commodity” as to mean a commodity which without the purchaser being present is placed in a package of whatever nature, whether sealed or not, so that the product contained therein has a pre-determined quantity;

## Person

As per section 2(m) the term “person” includes,-

- (i) a Hindu undivided family,
- (ii) every department or office,
- (iii) every organisation established or constituted by Government,
- (iv) every local authority within the territory of India,
- (v) a company, firm and association of individuals,
- (vi) trust constituted under an Act,
- (vii) every co-operative society, constituted under an Act,
- (viii) every other society registered under the Societies Registration Act, 1860;

## Premises

As per section 2 (n) the term “premises” includes—

- (i) a place where any business, industry, production or transaction is carried on by a person, whether by himself or through an agent, by whatever name called, including the person who carries on the business in such premises,
- (ii) a warehouse, godown or other place where any weight or measure or other goods are stored or exhibited,
- (iii) a place where any books of account or other documents pertaining to any trade or transaction are kept,
- (iv) a dwelling house, if any part thereof is used for the purpose of carrying on any business, industry, production or trade,
- (v) a vehicle or vessel or any other mobile device, with the help of which any transaction or business is carried on;

## Repairer

Section 2 (P) defines repairer” as to mean a person who repairs a weight or measure and includes a person who adjusts, cleans, lubricates or paints any weight or measure or renders any other service to such weight or measure to ensure that such weight or measure conforms to the standards established by or under this Act;

## Sale

“Sale”, with its grammatical variations and cognate expressions, means transfer of property in any weight, measure or other goods by one person to another for cash or for deferred payment or for any other valuable consideration and includes a transfer of any weight, measure or other goods on the hire-purchase system or any other system of payment by instalments, but does not include a mortgage or hypothecation of, or a charge or pledge on, such weight, measure or other goods;[section 2 (r)]

## Seal

As per section 2(s) "seal" means a device or process by which a stamp is made, and includes any wire or other accessory which is used for ensuring the integrity of any stamp;

## Stamp

Section 2(t) defines "stamp" as to mean a mark, made by impressing, casting, engraving, etching, branding, affixing pre-stressed paper seal or any other process in relation to, any weight or measure with a view to-

- (i) certifying that such weight or measure conforms to the standard specified by or under this Act, or
- (ii) indicating that any mark which was previously made thereon certifying that such weight or measure conforms to the standards specified by or under this Act, has been obliterated;

## Transaction

Under section 2(u)"transaction" means,-

- (i) any contract, whether for sale, purchase, exchange or any other purpose, or
- (ii) any assessment of royalty, toll, duty or other dues, or
- (iii) the assessment of any work done, wages due or services rendered;

## Verification

As per section 2(v) "verification", with its grammatical variations and cognate expressions, includes, in relation to any weight or measure, the process of comparing, checking, testing or adjusting such weight or measure with a view to ensuring that such weight or measure conforms to the standards established by or under this Act and also includes re-verification and calibration;

## Weight and measure

Under section 2(w) "weight or measure" means a weight or measure specified by or under this Act and includes a weighing or measuring instrument.

## STANDARD WEIGHTS AND MEASURES

Chapter II of the Act containing sections 4 to 12 deals with standard weight and measure. Section 4 provides units of weights and measures to be based on metric system. Section 5 provides the base unit of weights and measures. Section 6 deals with base unit of numeration. Section 7 provides the standard units of weights and measures. Section 8 states standard weight, measure or numeral. Section 9 provides the reference, secondary and working standard. Section 10 deals with use of weight or measure for particular purposes. Section 11 contains prohibition of quotation, etc., otherwise than in terms of standard units of weight, measure or numeration.

Section 4 of the Act provides that every unit of weight or measure shall be in accordance with the metric system based on the international system of units.

Section 5 of the Act provides that the base unit of length shall be the meter; mass shall be the kilogram; time shall be the second; electric current shall be the ampere; thermodynamic temperature shall be the Kelvin; luminous intensity shall be the candela; and amount of substance shall be the mole.

Section 6 states that the base unit of numeration shall be the unit of the international form of Indian numeral. Every numeration shall be made in accordance with the decimal system. The decimal multiples and sub-multiples of the numerals shall be of such denominations and be written in such manner as may be prescribed.

As per section 7 of the Act the base units of weights and measures specified in section 5 shall be the standard units of weights and measures. The base unit of numeration specified in section 6 shall be the standard unit of numeration. For the purpose of deriving the value of base, derived and other units mentioned in section 5, the Central Government shall prepare or cause to be prepared objects or equipments in such manner as may be

prescribed. The physical characteristics, configuration, constructional details, materials, equipments, performance, tolerances, period of re-verification, methods or procedures of tests shall be such as may be prescribed.

Section 8 provides that any weight or measure which conforms to the standard unit of such weight or measure and also conforms to such of the provisions of section 7 as are applicable to it shall be the standard weight or measure. Any numeral which conforms to the provisions of section 6 shall be the standard numeral.

No weight, measure or numeral, other than the standard weight, measure or numeral, shall be used as a standard weight, measure or numeral. No weight or measure, shall be manufactured or imported unless it conforms to the standards of weight or measure specified under section 8.

However, the aforesaid provisions shall not apply for manufacture done exclusively for export or for the purpose of any scientific investigation or research.

Section 11 of the Act provides that no person shall, in relation to any goods, things or service, quote, or make announcement of, whether by word of mouth or otherwise, any price or charge, or issue or exhibit any price list, invoice, cash memo or other document, or prepare or publish any advertisement, poster or other document, or indicate the net quantity of a pre-packaged commodity, or express in relation to any transaction or protection, any quantity or dimension, otherwise than in accordance with the standard unit of weight, measure or numeration.

It may be noted that the provisions mentioned above shall not be applicable for export of any goods, things or service.

Section 12 provides that any custom, usage, practice or method of whatever nature which permits a person to demand, receive or cause to be demanded or received, any quantity of article, thing or service in excess of or less than, the quantity specified by weight, measure or number in the contract or other agreement in relation to the said article, thing or service, shall be void.

### Appointment and Power of Director, Controller and legal metrology officers

Chapter III of the Act containing sections 13 to 23 of the Act deals with appointment and powers of director, controller and legal metrology officers.

Section 13 of the Act empowers the Central Government to appoint (by Notification) a Director of legal metrology, Additional Director, Joint Director, Deputy Director, Assistant Director and other employees for exercising the powers and discharging the duties conferred or imposed on them by or under this Act in relation to inter-State trade and commerce.

The Director and every legal metrology officer, appointed, shall exercise such powers and discharge such functions in respect of such local limits as the Central Government may, by notification, specify. Every legal metrology officer shall exercise powers and discharge duties under the general superintendence, direction and control of the Director.

The Director, the Controller and every legal metrology officer authorised to perform any duty by or under this Act shall be deemed to be a public servant within the meaning of section 21 of the Indian Penal Code. No suit, prosecution or other legal proceeding shall lie against the Director, the Controller and legal metrology officer authorised to perform any duty by or under this Act in respect of anything which is in good faith done or intended to be done under this Act or any rule or order made there under.

The Central Government may, with the consent of the State Government and subject to such conditions, limitations and restrictions as it may specify in this behalf, delegate such of the powers of the Director under this Act as it may think fit to the Controller of legal metrology in the State, and such Controller may, if he is of opinion that it is necessary or expedient in the public interest so to do, delegate such of the powers delegated to him as he may think fit to any legal metrology officer and where any such delegation of powers is made by such Controller, the person to whom such powers are delegated shall exercise those powers in the same manner and with the same effect as if they had been conferred on him directly by this Act and not by way of delegation.

Section 14 of the Act, provides that the State Government may, by notification, appoint a Controller of legal metrology, Additional Controller, Joint Controller, Deputy Controller, Assistant Controller, Inspector and other employees for the State for exercising the powers and discharging the duties conferred or imposed on them by or under this Act in relation to intra State trade and commerce.

The Controller and every legal metrology officer so appointed shall exercise such powers and discharge such functions in respect of such local limits as the State Government may, by notification, specify. Every legal metrology officer shall exercise and discharge the duties under the general superintendence, direction and control of the Controller.

### Power of inspection, seizure

Section 15 of the Act confer powers of inspection on the Director, Controller or any legal metrology officer may, if he has any reason to believe, whether from any information given to him by any person and taken down in writing or from personal knowledge or otherwise, that any weight or measure or other goods in relation to which any trade and commerce has taken place or is intended to take place and in respect of which an offence punishable under this Act appears to have been, or is likely to be, committed are either kept or concealed in any premises or are in the course of transportation.

The powers include entry at any reasonable time into any such premises and search for and inspect any weight, measure or other goods in relation to which trade and commerce has taken place, or is intended to take place and any record," register or other document relating thereto. The power also include seizure of any weight, measure or other goods and any record, register or other document or article which he has reason to believe may furnish evidence indicating that an offence punishable under the Act has been, or is likely to be, committed in the course of or in relation to, any trade and commerce.

Where any goods seized are subject to speedy or natural decay, the Director, Controller or legal metrology officer may dispose of such goods in such manner as may be prescribed. Every search or seizure made under this section shall be carried out in accordance with the provisions of the Code of Criminal Procedure, 1973, relating to searches and seizures.

### Forfeiture

Every non-standard or unverified weight or measure and every package used in the course of, or in relation to, any trade and commerce and seized under section 15, shall be liable to be forfeited, to the State Government. However, such unverified weight or measure shall not be forfeited to the State Government if the person from whom such weight or measure was seized gets the same verified and stamped within such time as may be prescribed. Every weight, measure or other goods seized under section 15 but not forfeited shall be disposed of by such authority and in such manner as may be prescribed.

### Manufacturers. etc., to maintain records and registers

Section 17 of the Act provides that every manufacturer, repairer or dealer of weight or measure shall maintain such records and registers as may be prescribed. The records and registers maintained shall be produced at the time of inspection to the persons authorised for the purpose of Inspection.



#### Declarations on pre-packaged commodities

*Section 18 states that no person shall manufacture, pack, sell, import, distribute, deliver, offer, expose or possess for sale any pre-packaged commodity unless such package is in such standard quantities or number and bears thereon such declarations and particulars in such manner as may be prescribed. Any advertisement mentioning the retail sale price of a pre- packaged commodity shall contain a declaration as to the net quantity or number of the commodity contained in the package in such form and manner as may be prescribed.*

## Registration for importer of weight or measure

Section 19 provides that no person shall import any weight or measure unless he is registered with the Director in such manner and on payment of such fees, as may be prescribed. No weight or measure, whether singly or as a part or component of any machine shall be imported unless it conforms to the standards of weight or measure established by or under this Act (Section 20).

## Approval of model

Every person, before manufacturing or importing any weight or measure shall seek the approval of model of such weight or measure in such manner, on payment of such fee and from such authority as may be prescribed. However, such approval of model may not be required in respect of any cast iron, brass, bullion, or carat weight or any beam scale, length measures (not being measuring tapes) which are ordinarily used in retail trade for measuring textiles or timber, capacity measures, not exceeding twenty litre in capacity, which are ordinarily used in retail trade for measuring kerosene, milk or potable liquors.

It may be noted that the prescribed authority may, if he is satisfied that the model of any weight or measure which has been approved in a country outside India conforms to the standards established by or under this Act, approve such model without any test or after such test as he may deem fit.

## Prohibition manufacture, repair or sale of weight or measure without licence

Section 23 of the Act provides that no person shall manufacture, repair or sell, or offer, expose or possess for repair or sale, any weight or measure unless he holds a licence issued by the Controller. However, no licence to repair shall be required by a manufacturer for repair of his own weight or measure in a State other than the State of manufacture of the same. The Controller shall issue a licence in such form and manner, on such conditions, for such period and such area of jurisdiction and on payment of such fee as may be prescribed.

Section 24 provides for verification and stamping of weight or measure. Every person having any weight or measure in his possession, custody or control in circumstances indicating that such weight or measure is being, or is intended or is likely to be, used by him in any transaction or for protection, shall, before putting such weight or measure into such use, have such weight or measure verified at such place and during such hours as the Controller may, by general or special order, specify in this behalf, on payment of such fees as may be prescribed.

The Central Government may prescribe the kinds of weights and measures for which the verification is to be done through the Government approved Test Centre. The Government approved Test Centre shall be notified by the Central Government or the State Government, as the case may be, in such manner, on such terms and conditions and on payment of such fee as may be prescribed.

## Offences and penalties

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Chapter V of the Act deals with offences and penalties.

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Section 25 of the Act provides for penalty for use of non-standard Weight or measure. The section stipulates that whoever uses or keeps for use any weight or measure or makes use of any numeration otherwise than in accordance with the standards of weight or measure or the standard of numeration, as the case may be, specified by or under this Act, shall be punished with fine which may extend to twenty-five thousand rupees and for the second or subsequent offence, with imprisonment for a term which may extend to six months and also with fine.

Under section 26 whoever tampers with, or alters in any way, any reference standard, secondary standard or working standard or increases or decreases or alters any weight or measure with a view to deceiving any person or knowing or having reason to believe that any person is likely to be deceived thereby, except where such alteration is made for the correction of any error noticed therein on verification, shall be punished with fine which may extend to fifty thousand rupees and for the second and subsequent offence with imprisonment for a term which shall not be less than six months but which may extend to one year or with fine or with both.

Section 27 provides that every person who manufactures or causes to be manufactured or sells or offers, exposes or possesses for sale, any weight or measure which does not conform to the standards of weight or measure specified by or under this Act; or which bears thereon any inscription of weight, measure or number which does not conform to the standards of weight, measure or numeration specified by or under this Act, except where he is permitted to do so under this Act, shall be punished with a fine which may extend to twenty thousand rupees and for the second or subsequent offence with imprisonment for a term which may extend to three years or with fine or with both.

Section 30 dealing with penalty for transaction in contravention of standard weight or measure provides that whoever, in selling any article or thing by weight, measure or number, delivers or causes to be delivered to the purchaser any quantity or number of that article or thing less than the quantity or number contracted for or paid for; or in rendering any service by weight, measure or number, renders that service less than the service contracted for or paid for; or in buying any article or thing by weight, measure or number, fraudulently receives, or causes to be received any quantity or number of that article or thing in excess of the quantity or number contracted for or paid for; or in obtaining any service by weight, measure or number, obtains that service in excess of the service contracted for or paid for, shall be punished with fine which may extend to ten thousand rupees, and; for the second or subsequent offence, with imprisonment for a term which may extend to one year, or with fine, or with both.

Under section 31, Whoever, being required by or under this Act or the rules made thereunder to submit returns, maintain any record or register, or being required by the Director or the Controller or any legal metrology officer to produce before him for inspection any weight or measure or any document, register or other record relating thereto, omits or fails without any reasonable excuse, so to do, shall be punished with fine which may extend to five thousand rupees and for the second or subsequent offence, with imprisonment for a term which may extend to one year and also with fine.

Section 35 provides that whoever renders or causes to be rendered, any service through means other than the weight or measure or numeration or in terms of any weight, measure or number other than the standard weight or measure, shall be punished with fine which shall not be less than two thousand rupees but which may extend to five thousand rupees and for the second or subsequent offence, with imprisonment for a term which shall not be less than three months but which may extend to one year, or with fine, or with both.

Under section 36 whoever manufactures, packs, imports, sells, distributes, delivers or otherwise transfers, offers, exposes or possesses for sale, or causes to be sold, distributed, delivered or otherwise transferred, offered, exposed for sale any pre-packaged commodity which does not conform to the declarations on the package as provided in this Act, shall be punished with fine which may extend to twenty-five thousand rupees, for the second offence, with fine which may extend to fifty thousand rupees and for the subsequent offence, with fine which shall not be less than fifty thousand rupees but which may extend to one lakh rupees or with imprisonment for a term which may extend to one year or with both. Whoever manufactures or packs or imports or causes to be manufactured or packed or imported, any pre-packaged commodity, with error in net quantity as may be prescribed shall be punished with fine which shall not be less than ten thousand rupees but which may extend to fifty thousand rupees and for the second and subsequent offence, with fine which may extend to one lakh rupees or with imprisonment for a term which may extend to one year or with both.

Section 42 provides for vexatious search and empowers the Director, the Controller or any legal metrology officer, exercising powers under this Act or any rule made thereunder, who knows that there are no reasonable grounds for so doing, and yet searches, or causes to be searched, any house, conveyance or place; or searches any person; or seizes any weight; measure or other movable property shall, for every such offence, be punished with imprisonment for a term which may extend to one year, or with fine which may extend to ten thousand rupees or with both.

### **Penalty for counterfeiting or seals**

Section 44 provides that whoever counterfeits any seal specified by or under this Act or the rules made thereunder, or sells or otherwise disposes of any counterfeit seal or possesses any counterfeit seal, or counterfeits or removes or tampers with any stamp, specified by or under this Act or rules made thereunder, or affixes the stamp so removed on, or inserts the same into, any other weight or measure, shall be punished with imprisonment for a term which shall not be less than six months but which may extend to one year and for the second or subsequent offence, with imprisonment for a term which shall not be less than six months but which may extend to five years.

Counterfeit" shall have the meaning assigned to it in section 28 of the Indian Penal Code.



A person is said to "counterfeit" who causes one thing to resemble another thing, intending by means of that resemblance to practice deception, or knowing it to be likely that deception will thereby be practiced.

Whoever obtains, by unlawful means, any seal specified by or under this Act or the rules made thereunder and uses, or causes to be used, any such seal for making any stamp on any weight or measure with a view to representing that the stamp made by such seal is authorised by or under this Act or the rules made thereunder shall be punished with imprisonment for a term which shall not be less than six months but which may extend to one year and for the second or subsequent offence, with imprisonment for a term which shall not be less than six months but which may extend to five years.

Whoever, being in lawful possession of a seal specified by or under this Act or the rules made thereunder, uses, or causes to be used, such seal without any lawful authority for such use, shall be punished with imprisonment for a term which shall not be less than six months but which may extend to one year and for the second or subsequent offence, with imprisonment for a term which shall not be less than six months but which may extend to five years.

Whoever sells or offers or exposes for sale or otherwise disposes of any weight or measure which, he knows or has reason to believe, bears thereon a counterfeit stamp, shall be punished with imprisonment for a term which shall not be less than six months but which may extend to one year and for the second or subsequent offence, with imprisonment for a term which shall not be less than six months but which may extend to five years.

**Explanation 1.** It is not essential to counterfeiting that the imitation should be exact.

**Explanation 2.** When a person causes one thing to resemble another thing, and the resemblance is such that a person might be deceived thereby, it shall be presumed, until the contrary is proved, that the person so causing the one thing to resemble the other thing intended by means of that resemblance to practice deception or knew it to be likely that deception would thereby be practiced.

### Compounding of offence

In terms of offence punishable under section 25, sections 27 to 39, sections 45 to 47 either before or after the institution of the prosecution, be compounded, on payment for credit to the Government of such sum as may be prescribed.

However, the Director or legal metrology officer as may be specially authorised by him in this behalf, may compound offences punishable under section 25, sections 27 to 39, or any rule made under sub-section (3) of section 52. The Controller or legal metrology officer specially authorised by him, may compound offences punishable under section 25, sections 27 to 31, sections 33 to 37, sections 45 to 47, and any rule made under sub-section (3) of section 52:

Provided that such sum shall not, in any case, exceed the maximum amount of the fine, which may be imposed under this Act for the offence so compounded.

### Offences by companies

Section 49 provides that where an offence under this Act has been committed by a company, the person, if any, who has been nominated to be in charge of, and responsible to, the company for the conduct of the business of the company (hereinafter in this section referred to as a person responsible); or where no person has been nominated, every person who at the time the offence was committed was in charge of, and was responsible to, the company for the conduct of the business of the company; and the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

However, such person shall not be liable to any punishment, if he proves that the offence was committed without his knowledge and that he exercised all due diligence to prevent the commission of such offence.

Any company may, by order in writing, authorise any of its directors to exercise all such powers and take all such steps as may be necessary or expedient to prevent the commission by the company of any offence under this Act and may give notice to the Director or the concerned Controller or any legal metrology officer authorised in this behalf by such Controller in such form and in such manner as may be prescribed, that it has nominated such director as the person responsible, along with the written consent of such director for being so nominated.

It may be noted that where a company has different establishments or branches or different, units in any establishment or branch, different persons may be nominated under this subsection in relation to different establishments or branches or units and the person nominated in relation to any establishment, branch or unit shall be deemed to be the person responsible in respect of such establishment, branch or unit.

Where an offence under the Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to the neglect on the part of, any director, manager, secretary or other officer, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Where any company is convicted under the Act for contravention of any of the provisions thereof, it shall be competent for the court convicting the company to cause the name and place of business of the company, nature of the contravention, the fact that the company has been so convicted and such other particulars as the court may consider to be appropriate in the circumstances of the case, to be published at the expense of the company in such newspaper or in such other manner as the court may direct. No publication shall be made until the period for preferring an appeal against the orders of the court has expired without any appeal having been preferred, or such an appeal, having been preferred, has been disposed of. The expenses of any publication shall be recoverable from the company as if it were a fine imposed by the court.'

**'Explanation.-** For the purposes of this section,-

- (a) "company" means any body corporate and includes a 'firm or other association of individuals; and
- (b) "director", in relation to a firm, means a partner in the firm but excludes nominated directors, honorary directors, Government nominated directors.

### Power of the Central Government to make rules

Section 52 of the Act empowers the Central Government to make rules, by notification, for carrying out the provisions of the Act.

In making any rule the Central Government may provide that a breach thereof shall be punishable with fine which may extend to five thousand rupees.

Every rule made by the Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the rule or both Houses agree that the rule should not be made, the rule shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that rule.

### Power of State Government to make rules

Section 53 empowers the State Government to make rules, by notification, and after consultation with the Central Government, to carry out the provisions of the Act.

In making any rule under this section, the State Government may provide that a breach thereof shall be punishable with fine which may extend to five thousand rupees. The power to make rules under this section shall be subject to the condition of the rules being made after previous publication in Official Gazette. Every rule made under this section shall, as soon as may be after it is made, be laid before each House of State Legislature, where there are two Houses and where there is one House of State Legislature, before that House.

### LESSON ROUND-UP

- Weights and measures may be ranked among the necessities of life to every individual of human society. They enter into the economical arrangements and daily concerns of every family.
- Legal metrology Act, 2009 intend to establish and enforce standards of weights and measures, regulate trade and commerce in weights, measures and other goods which are sold or distributed by weight, measure or number and for matters connected therewith or incidental thereto.
- “Legal Metrology” means that part of metrology which treats units of weighment and measurement, methods of weighment and measurement and weighing and measuring instruments, in relation to the mandatory technical and legal requirements which have the object of ensuring public guarantee from the point of view of security and accuracy of the weighments and measurements.
- Every unit of weight or measure to be in accordance with the metric system based on the international system of units.
- A person shall not manufacture, pack, sell, import, distribute, deliver, offer, expose or possess for sale any pre-packaged commodity unless such package is in such standard quantities or number and bears thereon such declarations and particulars in such manner as may be prescribed.
- Any advertisement mentioning the retail sale price of a pre-packaged commodity shall contain a declaration as to the net quantity or number of the commodity contained in the package in such form and manner as may be prescribed.
- Legal Metrology Act provides for penalty for use of non-standard Weight or measure.
- Label means any written, marked, stamped, printed or graphic matter affixed to, or appearing upon any pre-packaged commodity.
- A person is said to “counterfeit” who causes one thing to resemble another thing, intending by means of that resemblance to practice deception, or knowing it to be likely that deception will thereby be practiced.
- Legal Metrology Act empowers the Central Government and State Governments to make rules for carrying out the provisions of this Act.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

- What are the objectives of Legal Metrology Act, 2009?
- Enumerate the powers and functions of Controller and Legal Metrology Officer?
- Write short note on Counterfeit.
- Every non-standard weight and measure used in the course of trade is liable to be forfeited Comment.
- Briefly explain the provision regarding declaration on pre-packed commodities.

## Lesson 16

# Transfer of Property Act, 1882

### ***Key Concepts One Should Know***

- Instrument
- Moveable Property
- Immoveable Property
- Doctrine of Election
- Doctrine of Part-Performance
- Doctrine of Lis Pendens

### ***Learning Objectives***

#### **To understand:**

- Types of Properties
- Know Rules relating to Transfer of Property
- Properties which cannot be Transferred
- Lis Pendens
- Provisions Relating to Sale; Mortgage, Charge, Lease.

### ***Regulatory Framework***

- Transfer of Property Act, 1882

### ***Lesson Outline***

- Important Definitions
- Distinction between Moveable and Immoveable Property
- Rules relating to Transfer of Property
- Who can transfer the Property
- Subject matter of Transfer
- Rules against Inalienability
- Transfer for benefit of Unborn Person
- Conditional Transfer
- Doctrine of Election
- Doctrine of Holding Out
- Doctrine of Feeding the Grant by Estoppel
- Doctrine of Fraudulent Transfer
- Doctrine of Part-Performance
- Properties which cannot be Transferred
- Rule against Perpetuity
- Accumulation of Income
- Doctrine of Lis Pendens
- Provisions relating to Specific Transfers
- Actionable Claims
- LESSON ROUND-UP
- TEST YOURSELF

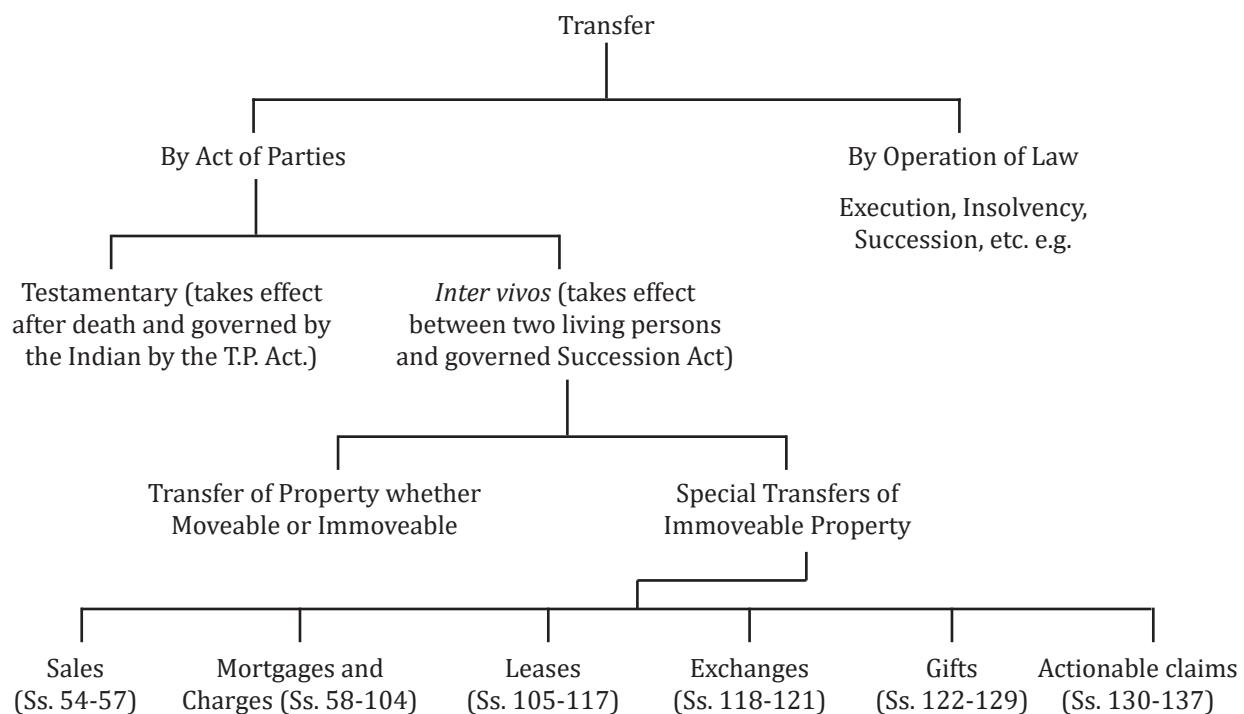
## INTRODUCTION

The law relating to transfer of property is governed by the Transfer of Property Act, 1882. Before this Act came into force there was practically no law as to real property in India. Barring few points which were covered by certain Regulations and Acts, the Courts in India in the absence of any statutory provisions, applied rules of English law as the rule of *justice, equity and good conscience*.

The Act was enacted with the object to *amend the law relating to the transfer of property by act of parties*. The Act excludes from its purview the transfers by operation of law, i.e. by sale in execution, forfeiture, insolvency or intestate succession. The scope of the Act is limited, as it is confined to transfers *inter vivos* and excludes testamentary succession, i.e. transfers *by will*.

The very preamble to the Act suggests that it simply defines and amends certain parts of the law relating to transfer of property by act of parties, and it does not at all profess to be an exhaustive enactment as is revealed by the omission of the word "*consolidate*". Therefore, the Act leaves the scope for applying rules of *justice, equity and good conscience* if a particular case is not covered by any of the provisions of the Act. But if it is covered, the Act must be applied.

### SCHEME OF THE ACT



## IMPORTANT DEFINITIONS

However, while explaining the provisions of the Act, the terms used are defined there itself, yet some of the important terms used under the Act are as follows:

### Instrument

Instrument means a non-testamentary instrument.

### Attached to the earth

Attach to the earth means:

- rooted in the earth, as in the case of trees and shrubs;
- imbedded in the earth, as in the case of walls or buildings; or

(c) attached to what is so embedded for the permanent beneficial enjoyment of that to which it is attached.

### Absolute Interest

When a person owns property, he has an “absolute interest” in the property. Ownership consists of a bundle of rights, the right to possession, right to enjoyment and right to do anything such as selling, mortgaging or making gift of the property. If A is the owner of a land, he has an absolute interest in the land. If A sells his land to B, then B becomes the owner and he acquires an absolute interest in the land he has purchased from A. Likewise if A makes a gift of his property to B, there again B gets an absolute interest in the property which is gifted to him. These are instances where persons may have an absolute interest.

### Reversion and Remainder

Some interests in the property are called in English Law, reversion and remainders. A “reversion” is the residue of an original interest which is left after the grantor has granted the lessee a small estate. For example, A, the owner of a land may lease it to B for a period of five years. The person who grants the lease is the lessor and the person who takes the lease is called the lessee. Here, after the period of 5 years the lease will come to an end and the property reverts back to the lessor. The property which reverts back to him is called the reversion or the reversionary interest. The grantor has a larger and an absolute interest out of which he carves out a smaller estate and gives to the grantees, i.e. the lessee.

When the owner of the property grants a limited interest in favour of a person or persons and gives the remaining to others, it is called a “remainder”. For instance, A the owner of a land transfers property to B for life and then to C absolutely. Here the interest in favour of B is a limited interest, i.e., it is only for life. So long as A is alive he enjoys the property. He has a limited right since he cannot sell away the property. His right is only to enjoy the property. If he sells this interest it will be valid so long as he is alive. So after B's death the property will go to C, interest is called a remainder. In the case of a “remainder”, the property will not come back to the owner, but it goes over to the other person.

### Vested and Contingent Interests

The word “vested” is used in two different senses. It may mean “vested in possession” or “vested in interest”. A right is said to be “vested in possession” when it is a right to present possession of property and it is said to be “vested in interest” when it is not a right to present possession but a present right to future possession. For instance, if a land is given to A for life with a remainder to B, A's right is vested in possession, B's right is vested in interest. In the above example, the interest of B is not subject to any uncertain condition. It will come into his possession after A's life comes to an end. Therefore, an interest is said to be vested when it is not subject to any condition, precedent, i.e., when it is to take effect on the happening of an event which is certain, whereas an estate is contingent when the right to enjoyment depends upon the happening of an event which may or may not happen. Thus, a gift to A on the death of B creates a vested interest in A even during the life time of B for there is nothing more certain than death. But a gift to A on the marriage of B creates a contingent interest, for B may never marry at all but that contingent interest becomes vested if and when B marries.

A vested interest is transferable and heritable. If property is given to A for life and afterwards to B, B gets a vested interest and if B transfers this interest to C, C will take when the life estate of A comes to an end. B's interest, since it is vested, is also heritable. Therefore, if B dies during the lifetime of A, C will get the property after the death of A.

A contingent interest, as said above, is an interest which takes effect after the condition is satisfied. It is subject to a condition precedent, i.e., unless A marries B's daughter, he will not get the property. The following example will illustrate this point. Property is given to A for life and then to B if he marries C. B should marry C before A dies. If he does so, his interest is converted into vested interest. Before B marries C his interest is contingent. The contingent interest is not heritable although it is transferable. In a vested interest the transfer is complete, but when the interest is contingent the transfer depends upon a condition precedent. In a condition precedent the estate is not vested in the grantee until the condition is fulfilled.

*Distinction between a vested and a contingent interest:* The following are the principal points of distinction between a vested and a contingent interest:

1. When an interest is vested the transfer is complete. It creates an immediate proprietary interest in the property though the enjoyment may be postponed to a future date. A contingent interest on the other hand is dependant upon the fulfilment of some conditions which may or may not happen. In other words, in case of vested interest, the owner's title is already perfect; in case of a contingent interest, the title is as yet imperfect but may become perfect on the fulfilment of a stipulated condition.
2. A vested interest takes effect from the date of transfer. A contingent interest in order to become vested is conditioned by a contingency which may not occur.
3. A vested interest cannot be defeated by the death of the transferee before he obtains possession. A contingent interest may fail in case of the death of transferee before the fulfilment of condition.
4. Since vested interest is not circumscribed by any limitation which derogates from the completeness of the grant, it logically follows that a vested interest is transferable as well as heritable. If, therefore, a transferee of the vested interest dies before actual enjoyment, it will devolve on his legal heirs. A contingent interest, on the other hand, cannot be inherited though it may be transferred coupled with limitation regarding fulfilment of a condition.

## MOVEABLE AND IMMOVEABLE PROPERTY

The term "property" signifies the subject matter over which the right of ownership or any less right carved out of ownership (e.g. mortgage right) is exercised. The Act deals with (i) various specific transfers relating to Immoveable property and (ii) lays down general principles relating to transfer of both moveable and immoveable property. Chapter II of the Act is divided into two parts. Parts A deals with the rules pertaining to both moveable and immoveable property (Section 5 to 37), Part B embodies the rules relating to immoveable property (Section 38 to 53A). The other chapters of the Act deal with transfers such as sales, mortgages, leases, gifts, exchanges and actionable claims.

The rules relating to these transactions are referred to as rules governing special transfers to immoveable property. The fundamental rule relating to all transfers is that a transfer cannot be effected in any other way except as prescribed under the Act. Furthermore, the Act states that certain kinds of property cannot be transferred at all.

The first task is to define and distinguish between moveable and immoveable property.

### Moveable property

The Transfer of Property Act does not define the term "moveable property". Therefore, it is to be defined with the help of other statutes. For e.g., it has been defined in the General Clauses Act, 1897 as to mean "property of every description except immoveable property". The Registration Act defines "moveable property" to include property of every description excluding immoveable property but including standing timber, growing crops and grass.

For the purpose of law, moveable property is sometimes regarded as immoveable property. This may happen when a thing of chattel is attached or embedded in earth. For instance, if a machinery or a plant is installed on the land, the question arises whether the machinery or the plant is moveable property or immoveable property. In order to find out whether such a thing or chattel is an immoveable property or not, it is to find out the mode of annexation of the thing and the object or purpose of such annexation. If the machinery is fixed on the land permanently then it becomes immoveable property, whereas if the machinery or engine or any other thing is fixed on a temporary basis, then it will be regarded as moveable property.

Thus, where the owner of a piece of land installed a bone mill along with machinery being held by iron bars which have been dug to a considerable depth then it is a permanent fixture and this will become immoveable property. Similarly, the machinery installed on a cement platform and held in position by being attached to iron pillars fixed in the ground was held to be immoveable property as the annexation was made by the person who owned the buildings as well as the machinery (*Mohamed Ibrahim v. Northern Circars Fibre Trading Company, A.I.R. 1944 Mad. 492*).

### Immoveable property

The term “immoveable property” is also not defined under the Act. However, it is defined in the negative sense as “the immoveable property does not include standing timber, growing crops, or grass” (S. 3 Para 2). Standing timber are trees fit for use for building or repairing houses. This is an exception to the general rule that growing trees are immoveable property.

The General Clauses Act defines the term “immoveable property” but not exhaustively. It states: “immoveable property shall include land, benefits to arise out of land and things attached to the earth, or permanently fastened to any thing attached to the earth” [Section 3(25)]. The Indian Registration Act expressly includes under to immoveable property the benefits to arise out of land, hereditary allowances, rights of way, lights, ferries and fisheries.

If the definitions of “immoveable property” as given in the Transfer of Property Act, the General Clauses Act and the Registration Act are viewed together, it is evident that they do not say what immoveable property is. They only say what is either included or excluded therein. Still, reading the definition in the Act with one in the General Clauses Act, *immoveable property will be found to include land, benefit to arise out of land such as rent, and things attached to the earth* like trees and buildings *but not standing timber, growing crops and grass*. The last three things are regarded as severable from the land on which they stand and, therefore, they are not included in the term “immoveable property”.

#### Thus, the meaning of immoveable property is as under:



*Immoveable property* means land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth.

“Attached to the earth” means (a) rooted in the earth, as in the case of trees and shrubs; (b) embedded in the earth, as in the case of walls or buildings; or (c) attached to what is so embedded for the permanent beneficial enjoyment of that to which it is attached (S. 3 Para 6 of the Act).

*Things rooted in the earth:* Trees and Shrubs are immoveable property according to this definition subject to the exception as to standing timber.

*Things embedded in the earth:* A house being embedded in the earth is immoveable property and this is so even if it is sold for enjoyment as a house with an option to pull it down. The mode of annexation and object of annexation are the two tests to determine whether it is immoveable property or not.

*Attached to what is so...:* The attachment must be as the section says for the permanent beneficial enjoyment of that to which it is attached e.g. the doors, windows of a house or moveable parts of fixed machinery. But the attachment must be intended to be permanent.

A orally grants to B for Rs. 700/- the rights to catch and carry away fish from his lake. Is the grant valid? The Supreme Court in *Ananda Behra v. State of Orissa*, (1956) SCJ p. 96, that such a right is a benefit arising out of immoveable property namely the lake. So under General Clauses Act it is immoveable property. The sale requires a registered instrument for its validity under Section 54 of the Transfer of Property Act. Therefore, the oral grant is invalid and cannot pass away any title in favour of B.

**Growing crops:** It includes all vegetable growths which have no existence apart from their produce such as pan leaves, sugar cane etc.

**Grass:** Grass is moveable property, but if it is a right to cut grass it would be an interest in land and hence forms immoveable property.

### ***Distinction between moveable and immoveable property***



The distinction between moveable and immoveable property was explained in the case of *Sukry Kurdepa v. Goondakull*, (1872) 6 Mad. H.C. 71, by Holloway J. as moveability may be defined to be a capacity in a thing of suffering alteration. Immoveability for such alteration e.g., a piece of land in all circumstances is immoveable. If a thing cannot change its place without injury to the quality it is immoveable. Certain things e.g. trees attached to the ground are so long as they are so attached, immoveable when the severance has been effected they become moveable.

### ***The following have been recognised as immoveable property:***

|   |   |  |                    |
|---|---|--|--------------------|
| Right to collect rents of immoveable property | A right to way                                    | A right to collect dues from fair on a piece of land | Hereditary offices |
| The equity of redemption                      | The interest of mortgagee                         | Right to collect lac from trees                      | A right of ferry   |
| A right of fishery                            | Right to receive future rents and profits of land | Reversion in property leased                         | A factory          |

### ***The following have been held not to be immoveable property:***

|                  |                             |         |  |           |                                      |                              |
|------------------|-----------------------------|---------|--|-----------|--------------------------------------|------------------------------|
| Right of worship | Government promissory notes | Royalty | A right to recover maintenance allowance | Copyright | A decree for sale on a mortgage-deed | A decree for arrears of rent |
|------------------|-----------------------------|---------|--|-----------|--------------------------------------|------------------------------|

## RULES RELATING TO TRANSFER OF PROPERTY (WHETHER MOVEABLE OR IMMOVEABLE)

According to Section 5 of the Transfer of Property Act, the term "transfer of property" means an act by which a living person conveys property in present, or in future, to one or more other living persons, or to himself, and one or more other living persons and "to transfer property" is to perform such an act. In this section, "living person" includes a company or association or body of individuals whether incorporated or not. But the general provisions of the Act as to transfer do not effect the special provisions of the Companies Act, 1956.

To effect a transfer, property must be in existence. The word "transfer" is defined with reference to the word "convey". The fundamental rule is that a transfer cannot be affected in any way not prescribed by the Act.

*The first point to note is that transfer inter vivos* (i.e., between living persons) alone is contemplated by the Act. A transfer by means of a will is not a transfer according to the Act, because it is not a transfer between two living persons. Section 5 also says that the transfer may be "in present or in future". The words in present or in future qualify the words 'conveys', and not the word 'property'. A transfer of property not in existence operates as a contract to be performed in future which may be specially enforced as soon as the property comes into existence (*Jugalkishore v. Ram Cotton Company*, (1955) 1 SCR 1369).

Further Section 6 (h) provides that no transfer can be made in so far as it is opposed to the nature of the interest attached thereby or for an unlawful object or consideration or to a person legally disqualified to be a transferee.

### WHO CAN TRANSFER THE PROPERTY?

According to Section 7 of the Transfer of Property Act, every person who is competent to contract and entitled to transferable property, or authorised to dispose of property is competent to transfer such property. Hence, every person competent to contract and having ownership can transfer property. According to Indian Contract Act, a person is competent to contract when he is a major and of sound mind and is not disqualified from contracting by any law to which he is subject. But a minor can be a transferee as there is nothing in the Transfer of Property Act to disqualify a person, who is a minor to be a transferee. Thus, a mortgage can be validly executed in favour of a minor who has paid the consideration (*Hari Mohan v. Mohini*, 22 C.W.C. 130, *Raghava v. Srinivasa*, (1917) 60 Mad. 308). Persons who are authorised to transfer property can also transfer property validly. Although a minor is not competent to be a transferor yet a transfer to a minor is valid. However, there are exceptions to this:

If a person holds himself out as the owner with the consent of the owner i.e. doctrine of holding out or if a person represents to be the owner i.e. doctrine of feeding the grant by estoppel.

### SUBJECT MATTER OF TRANSFER

Section 6 of the Transfer of Property Act says that property of any kind may be transferred except as provided by this Act or any other law for the time being in force. The words "property of any kind" indicate that transferability is the general rule and the right to property includes the right to transfer the property to another person. Property of any kind excludes from its purview the future property. A transfer of future property can only operate as a contract which may be specifically performed when the property comes into existence.

### Exceptions to the general rule of transferability made by other laws

Certain restrictions are placed by Hindu law and Mohammedan law on the transfer of property.

### FORMALITIES OF TRANSFER

Property can be transferred either orally or by writing. Moveable property can be transferred by delivery of possession or by registration. Section 54 lays down the mode of transfer of immoveable property. Such transfer, in the case of *tangible* immoveable property of the value of one hundred rupees and upwards, or in the case of a *reversion* or other *intangible* thing, can be made only by a registered instrument.

In the case of *tangible* immoveable property of a value less than one hundred rupees, such transfer may be made either by a registered instrument or by delivery of the property.

The *tangible* property means a property which can be touched physically and hence, capable of physical dealing.

The *intangible* property means something in abstract, either capable of being touched or perceived and yet standing in relation to a certain thing.

'*Reversion*' means the bundle of rights remaining with the lessor after the execution of a lease of a certain immoveable property.

When a transfer is effected in writing, the person who signs the document professing to transfer the property is called the executant. Execution consists in affixing his signature to the document to the effect that he is transferring the property. An illiterate person who cannot write may direct some literate person to sign it on his behalf and in his presence and the illiterate person may put his thumb impression.

### (i) Attestation

Attestation is an important formality in connection with the execution of transfer. "Attest" means to testify a fact, to bear witness to a fact. Attestation, in relation to a document, signifies the fact of authentication of the signature of the executant of that document by the attestator by putting down his own signature on the document in testimony of the fact of its execution. All transfers do not require attestation. For example, a sale or a lease does not require attestation. But a mortgage or a gift requires that a mortgage deed or a gift deed must be attested by two or more witnesses.

Attestation is valid and complete when two witnesses sign the instrument. According to the definition given in the Transfer of Property Act (Section 3), the following essentials are required for a valid attestation:

- (a) There must be at least two or more witnesses;
- (b) Each witness must see (i) the executant's sign or affix his mark to the instrument, or (ii) some other person sign the instrument in the presence and by the direction of the executant, or (iii) receive from the executant a personal acknowledgement of his signature or mark or of the signature of such other person; and
- (c) Each witness must sign the instrument, (i.e. document), in the presence of the executant.

It is not necessary that both attesting witnesses should be present at the same time. The instrument may be attested after its execution by each of the attestors at different times. Attestation cannot take place before the execution of the deed. The Act does not insist on any particular form of attestation. The attesting witness may not be described as such on the face of the document (*Yakub v. Kalzurkan*, 52 Bombay 203). However, the attesting witness must have put his signature *antmus attestandi*, i.e., with intention to attest. Thus, where a Registrar or an identifying witness puts his signature on the document he cannot be regarded as an attesting witness unless it is duly proved that he signed with the necessary intention to attest.

### (ii) Registration

Registration is an essential legal formality to effect a valid transfer in certain cases. The advantage of registering a document is that any person who deals with the property would be bound by the rights that are created in earlier registered document.

#### Illustration

A executes a mortgage on property X and gets it registered. Subsequently he sells property X to B, B is bound by the right of the mortgagee over the property X. Thus, whether B knows actually or not that there was a mortgage the fact that the earlier document was registered is a notice to B and B takes property, subject to the rights of the mortgagee. Therefore, if a document of transfer relating to immoveable property is required by the law to be and has been effected by registered instrument, the persons who deal with the property subsequently are deemed in the eye of law as having knowledge of the such registered instrument from the date of its registration.

### (iii) Notice

Notice, may be actual or constructive. If a person knows about a fact, he has an actual notice. But, in certain circumstances law treats a man who ought to have known a fact even though he did not in fact know it. This is called constructive notice.

The equitable doctrine of notice is recognised in various Sections of this Act. For instance in Section 39 of the Act, where a transfer is made of property out of which a person has a right to receive maintenance, the transferee takes subject to that right if he had notice of it, but not otherwise. Similarly under Section 40 if A conveys to C property, which he had by a previous contract agreed to sell to B, then B can enforce the contract against C, if C had notice of it, but not otherwise. If C had notice of the prior contract, he purchases with knowledge that it was unconscionable of A to sell to him, and it is therefore, unconscionable of him to buy.

A person is deemed in the eye of law to have constructive notice of a fact when (i) but for willful absention from an enquiry or search which he ought reasonably to have made; or (ii) gross negligence on his part, he would have known it. Constructive notice arises from an irrefutable presumption of notice. In law such a presumption will arise when (i) there is a willful absention on the part of a person to make necessary enquiries regarding the existence of certain facts, or (ii) he showed gross negligence in the matter.

The words "wilful absention" suggest want of bona fide in respect of particular transaction (*Joshua v. Alliance Bank*, 22 Cal. 185). Thus, a person who refuses to receive a registered letter is, deemed to have constructive notice of its contents.

Similarly, if a person proposes to sell his property to X who, at the same time knows that rents due in respect of the property are paid by the tenants to a third person Y, X will be fixed with notice of the rights of Y (*Mernet v. Luck* (1902) 1 Ch. 429).

In so far as gross negligence is concerned, it does not mean a mere carelessness but means carelessness of such an aggravated nature as to indicate mental indifference to obvious risks. For example, if A buys property from B and does not care to ask whether any amount by way of municipal tax is due on that property and if the municipal corporation asks him to pay the arrears of tax, then B is responsible, and if he does not pay, then the arrears of tax may be made a charge on the property.

### Other Illustrations

- (a) Where a purchaser was informed that the title deeds were in the possession of a bank for safe custody and yet failed to make any enquiry in the bank. It was held that he was guilty of gross negligence and must be deemed to have notice of the rights of the bank which has the custody of the title needs (*Imperial Bank of India vs. Rai Gyand*, IA 283).
- (b) Where a person abstained from making further enquiries about the right of a person and did not cause a search, to be made in the office of the Sub-Registrar to ascertain if there was any encumbrance over the property, his omission must be held to be wilful or grossly negligent and he would be said to have notice of the prior encumbrances (*Rangappa Goundan vs. Marapa Goundan*, AIR (1958) Madras 515).

The three Explanations to the definition of notice in Section 3, further mention certain circumstances wherein statutorily presumption of knowledge arises. These circumstances relate to the fact of registration (Explanation-I, Explanation-II) actual possession and notice to an agent (Explanation-III).

### RESTRAINT ON TRANSFERS OR RULE AGAINST INALIENABILITY

Section 10 of the Act says that when property is transferred, the transferee should not be restrained absolutely from alienating the property. One may give property to another subject to a condition, but the condition should not be one which absolutely prevents the transferee from alienating the property. Suppose, B gives property to A and his heirs adding a condition that if the property is alienated it should revert to B. This condition is invalid and the transferee can ignore such condition. The transfer takes effect and is valid, and the condition not to alienate the property is void.

## Examples of absolute restraint

Suppose, A gives to B property worth only Rs. 2,000 rupees and adds a condition that B should sell property for Rs.50,000 and not below that amount, this condition will at once become invalid for no one will buy the property which is only worth Rs.2,000 for Rs. 50,000. Similarly, A gives to B property worth Rs.50,000 and stipulates that if B wants to sell the property he should sell it to C only for Rs. 1,000. This again will operate as an absolute restraint. In *Rosher vs. Rosher*, (1884) 26, Ch. D. 801, the testator gave his estate to his son and added a condition that if his son wanted to sell the property he should first give an option to the testator's wife who should be able to buy for £ 3,000. The market value of the property when the testator died was £ 15,000. It was held by the Court that the condition which compelled the son to sell the property for £ 3,000 was void. In *Trichinopoly Varthaga Sangum vs. Shunmoga Sunderam*, (1939) Madras 954, there was a partition between a Hindu father and his five sons. The deed of partition provided that if any one of the sons wanted to sell his share, he should not sell it to a stranger but to one of his brothers who should have the option to buy for a sum not exceeding Rs.1,000. It was held by the Court that the condition absolutely prevented the son from selling the property to any one for good value. In this case the market value of the property of the son was far greater than Rs.1,000. Hence, the condition was declared invalid.

## Partial restraint valid

Though absolute restraints are bad in law, partial restraints are valid. If there are conditions which restrain the transferee not to alienate the property outside the family, it has been held by the Courts that they are partial restraints. For example, whenever there are conditions in a family settlement whereby the members are not allowed to sell their shares to a stranger, such conditions are valid.

But it is not permissible to restrict the alienation to a particular time. Such a restriction is not partial but an absolute restraint and as such invalid.

## When absolute restraint valid?

There are two exceptions to the rule that absolute restraints are void. Firstly, in the case of a lease, the lessor can impose a condition that the lessee shall not sublet the property or sell his leasehold interest. Such conditions are valid. The reason why such an exception is made in the case of a lease is that the lessor may have confidence in the lessee but may not have the same confidence in some other person. So, if the lessor puts a condition restraining the lessee from transferring the property to someone, the condition is valid.

The second exception is made in respect of a woman who is not a Hindu, Buddhist or Muslim. In such a case, a condition to the effect that she shall not have power during her marriage to transfer the property is valid.

## Restraint on enjoyment

Section 11 of the Act also embodies a rule which is based on the principle that restraint on the enjoyment of the property is invalid. The section lays down that where land is transferred by one to another, the transferor should not impose conditions as to how and in what manner the transferee should enjoy the property.

### Illustrations

- (a) A sells his house to B and adds a condition that B only should reside in that house, the condition is invalid. This is subject to the exception that, if a person transfers a plot of land keeping another plot for himself, he can impose certain conditions which may interfere with the right of enjoyment of the transferee.
- (b) A has properties X and Y. He sells property Y to B and puts a condition that B should not construct on property Y more than one storey so that A's property X which he retains should have good light and free air.

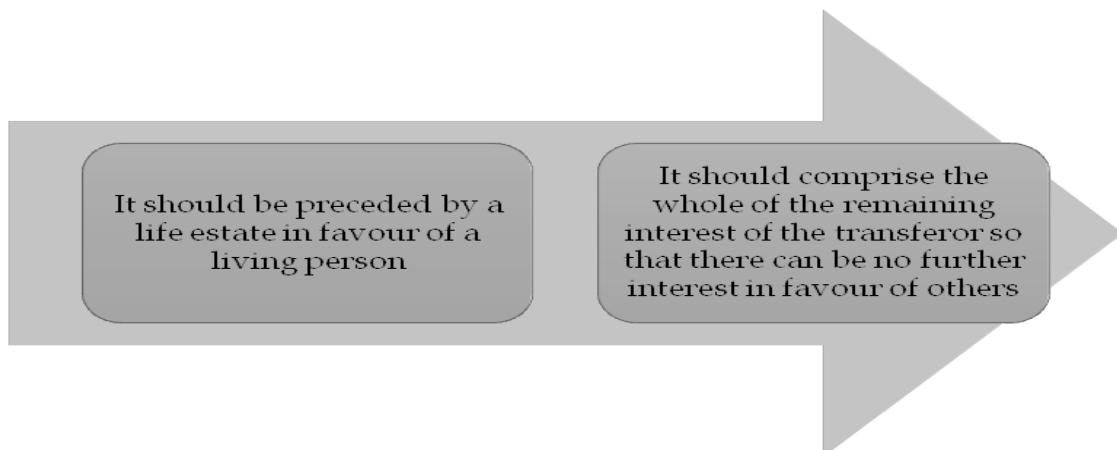
Thus, it is clear in the above illustration that the condition which is imposed by A is for the benefit of another property which he retains. Such a condition is valid.

Section 12 also makes the transfer void if a property is transferred to any person adding a condition that if such person becomes insolvent he ceases to hold that property. Such a condition is not recognised as valid in law. Again,

this is subject to the exception that if a landlord leases his property he can impose a condition on the lessee that if the lessee becomes insolvent the lease should come to an end.

## TRANSFER FOR BENEFIT OF UNBORN PERSON

Section 13 of the Transfer of Property Act lays down that where on a transfer of property, an interest therein is created for the benefit of a person not in existence at the date of transfer, subject to a prior interest created by the same transfer, the interest created for the benefit of such person shall not take effect unless it extends to the whole of the remaining interest of the transferor in the property. Thus if a property is given to an unborn person, two conditions should be satisfied:



### Illustration

A transfers property of which he is the owner to B in trust for A and his intended wife successively for their lives, and after the death of the survivor, for the eldest son of the intended marriage for life, and after his death for A's second son. The interest so created for the benefit of the eldest son does not take effect, because it does not extend to the whole of A's remaining interest in the property.

## CONDITIONAL TRANSFER

When an interest is created on the transfer of property but is made to depend on the fulfillment of a condition by the transferee, the transfer is known as a conditional transfer. Such a transfer may be subject to a condition precedent or a condition subsequent. If the interest is made to accrue on the fulfillment of a condition, the condition is said to be condition precedent. For instance, A agrees to sell his land to B if B marries C. This is a condition precedent. The condition precedent will be allowed to operate only if it is not hit by the provisions of Section 25 of the Act. Section 25 in the first place, says that, the condition must not be impossible to fulfil. For example, A lets a farm to B on condition that he shall walk a hundred miles in an hour. The lease is void. Secondly, the condition must not be forbidden by law. Thirdly, it should not be of such a nature that if permitted it would defeat the provisions of any law. For instance, A transfers Rs. 500 to B on condition that he shall murder C. The transfer is void. Fourthly, it should not be fraudulent. For example, X gives a false receipt to Y on behalf of his principal in consideration of transfer of land. The transfer would be void. Fifthly, the condition should not be such as to cause injury to the person or property of another. And lastly the condition should not be immoral or opposed to public policy. Thus, an agreement to give a son or daughter in adoption for a consideration is opposed to public policy as trafficking in children is forbidden by law.

If the condition is not hit by any of the above provisions, it is valid. Still the law does not insist on its literal fulfillment. It is sufficient if it is substantially complied with. Thus, where A transfers, Rs. 5,000 to B on condition that he shall marry with the consent of C, D and E. B marries with the consent of C and D only as E has died earlier. B is deemed to have fulfilled the condition.

A transfer may also be made subject to a contingency which may or may not occur. Thus, an interest may be created with the condition superadded that it shall cease to exist in case a specified uncertain event shall happen, or in case a specified uncertain event shall not happen.

This is known as condition subsequent. Condition subsequent is one which destroys or divests the rights upon the happening or non-happening of an event. For example, A transfers a farm to B for his life with a proviso that in case B cuts down a certain wood, the transfer shall cease to have any effect. B cuts down the wood. He loses his life interest in the farm. Similarly, if A transfers a farm to B provided that B shall not go to England within three years after the date of transfer, the interest in the farm shall cease. B does not go to England within the term prescribed. His interest in the farm ceases.

Now you will notice the distinction between condition precedent and condition subsequent. In condition precedent, the condition comes before the interest; whereas in condition subsequent, the interest is created before the condition. The one precedes the vesting of right and the other follows the vesting. In condition precedent, the vesting of right is delayed until the happening of an event. In condition subsequent, there is no postponement of vesting of right though it is to be destroyed or divested by reason of non-fulfilment of condition. There are certain situations where the law says that either the transfer will take effect on the fulfillment of a condition or will not take effect at all.

Again, if a transfer is made to defeat or delay the rights of a creditor, the transfer may be declared invalid by the creditor. In some cases, if property is transferred during the period when parties are litigating in a Court over a piece of property, then the transfer is not valid, or even if there is a transfer, it is subject to the rights that are created in the Court's decree. All these circumstances are given in the Transfer of Property Act e.g., doctrine of election, doctrine of fraudulent transfers and doctrine of Lis pendens.

## DOCTRINE OF ELECTION

Section 35 of the Transfer of Property Act deals with what is called doctrine of election. Suppose, a property is given to you and in the same deed of gift you are asked to transfer something belonging to you to another person. If you want to take the property you should transfer your property to someone else, otherwise you cannot take the property which is transferred to you by some one. Election may be defined as "the choosing between two rights where there is a clear intention that both were not intended to be enjoyed.

The foundation of doctrine of election is that a person taking the benefit of an instrument must also bear the burden, and he must not take under and against the same instrument. It is, therefore, a branch of a general rule that no one may approve and reprobate (Copper v. Copper (1874) H.L. 53). However doctrine of election could not be applied to deprive a person of his statutory right to appear invoking extraordinary jurisdiction of the Supreme Court under Article 136, (PR Deshpande v. MB Haribatti (1995 (2) Scale 804 SC).

### Illustration

A transfers to you his paddy field and in the same deed of transfer asks you to transfer your house to C. Now, if you want to have the paddy field you must transfer your house to C, because the transferor is transferring to you his paddy field on the condition that you give your house to C.

Thus, either you take the paddy field and part with your house or do not take it at all. This is called the doctrine of election. You must elect either to take under the instrument, in which case you will have to fulfil the condition and bear the burden imposed upon you or you must elect against the instrument, in which case neither the benefit nor the burden will come to you. The doctrine is based on the principle that "a donee shall not be allowed to approve and reprobate and that if he approves, he shall do all in his power to confirm the instrument which he approves" (Cavendish v. Decre 31 C.D. 466).

In case, the person upon whom benefit is conferred rejects it, the property which was attempted to be transferred to him will revert to the transferor and it is he who will compensate the disappointed person. If the transferor dies before the person upon whom the benefit is conferred and he rejects the transfer, then the representatives of the transferor will have to satisfy the disappointed person out of the property which was the subject of transfer.

## Explanation of the above principle

A transfers his property worth Rs.1,000 and by the same instrument asks B to transfer his property worth Rs.500 to C. Here, if B does not accept, he will not take A's property and the property will revert to A. If A is alive, it is for him to give some property to C. But if A dies before B has made his election then the heirs of A have to compensate C from A's property to the extent of Rs.500. (You will note that B's property worth Rs.500 was intended by A to be transferred to C).

The question of Election arises only when a transfer is made by the same document. If the transferor makes a gift of property by one deed and by another asks the donee to part with his own property then there is no question of election.

### Illustration

A transfers his land to B by a document. A by another document transfers B's property to C. In this case B can retain the property given to him and refuse to transfer his property to C as the two transfers do not form part of the same document.

Further, the doctrine of election is applicable if the benefit is given directly. A person taking no benefit directly under a transaction but deriving a benefit under it indirectly need not elect.

### Illustration

A transfers his property to B's son and by the same instrument transfer B's property to C. In this case B need not to elect and can keep his property. His son can have his gift.

There is, however, an exception to the doctrine of election. That is, if the transferor gives two benefits to a person and one particular benefit is in lieu of an item of property belonging to that person which the transferor has asked to transfer to a third-party then if the person elects to retain his property, he can retain the other benefit.

### Illustration

Under A's marriage settlement, his wife is entitled, if she survives him to the enjoyment of the estate of Sultanpur during her life. A by his will bequeaths to his wife an annuity of Rs.200 p.m. during her life, in lieu of her interest in the estate of Sultanpur, which estates he bequeaths to his son. A also gives his wife a legacy of Rs.1,000. After the death of A, his widow elects to take what she is entitled to take under the marriage settlement (i.e., the enjoyment of estate of Sultanpur). In this case, the wife has to forfeit the claim of Rs.200 which her husband has given to her. But she can claim other benefit i.e., Rs.1,000.

Election may be express or implied by conduct.

### Illustration

A transfers to B an estate to which C is entitled, and as part of the same transaction gives C a coal mine. C takes possession of the mine and exhausts it. He has thereby confirmed the transfer.

In case of disability, the condition shall be postponed until the disability ceases, or until the election is made by some competent authority.

## TRANSFER BY OSTENSIBLE OWNER OR DOCTRINE OF HOLDING OUT

Where, with the consent, express or implied, of the persons interested in immoveable property, a person is the ostensible owner of such property and transfers the same for consideration, the transfer shall not be voidable on the ground that the transferor was not authorised to make it, provided that the transferee, after taking reasonable care to ascertain that the transferor had power to make the transfer, has acted in good faith. (Section 41)

***The following conditions are necessary for the application of Section 41:***

The transferor is the ostensible owner

He is so by the consent express or implied, of the real owner

The transfer is for consideration

The transferee has acted in good faith taking reasonable care to ascertain that the transferor had power to transfer

If any one of these elements is absent, the transferee is not entitled to the protection of this section.

This Section is a statutory application of the law of estoppel. The section makes an exception to the rule that a person cannot confer a better title than he has. An ostensible owner is one who has all the indicia of ownership without being the real owner.

### Illustrations

- (a) A made a gift of property to B but continued in possession of the gifted property. He purported to exercise a power of revocation and then transferred the property to the defendant. The gift, however, was not revocable as it was an unconditional gift. B seeks to recover possession from the defendant. The defendant invoked protection under Section 41.  
In the given example, the donor is not an 'ostensible owner' holding the property with the consent of the real owner. The defendant cannot, therefore, invoke the protection of Section 41.
- (b) The manager of a joint Hindu family consisting of some minor members alienated the ancestral house to P without any necessity and the alienee transferred it to the defendants. The minors challenged the alienation. The defendants sought protection under Section 41.

Here Section 41 has no application for "P was not the ostensible owner of the ancestral family house with the consent, express or, implied, of the persons interested in the said ancestral house in as much as the plaintiff, who had an interest in the said house, did not and could not by reason of the disability of infancy give their consent".

### DOCTRINE OF FEEDING THE GRANT BY ESTOPPEL

Where, a person fraudulently or erroneously represents that he is authorised to transfer certain immoveable property and professes to transfer such property for consideration, such transfer shall, at the option of the transferee, operate on any interest which the transferor may acquire in such property at any time during which the contract of transfer subsists. (Section 43)

Nothing in this Section shall impair the right of transferees in good faith for consideration without notice of the existence of the said option.

***Essentials: In order to invoke this section, the transferee must prove that:***

There was a representation, fraudulent or erroneous

It was to the effect that the transferor is entitled to transfer the immoveable property

The transferor is found to have subsequently acquired the interest which he professed to transfer

The transfer of property was for consideration

The transferee has not rescinded the contract

The transferee acted in good-faith for consideration and without notice of the rights under the prior transfer

### Illustration

A, a Hindu, who has separated from his father B, sells to C three fields, X, Y and Z, representing that A is authorised to transfer the same. Of these fields, Z does not belong to A, it having been retained by B on the partition, but on B's dying, A as heir obtains Z. C, not having rescinded the contract of sale may require A to deliver Z to him. Thus, where a grantor has purported to grant an interest in land which he did not at that time possess, but subsequently acquires, the benefit of his subsequent acquisition goes automatically to the earlier grantee or as it usually expressed, feeds the estoppel.

### DOCTRINE OF FRAUDULENT TRANSFER

Where a person transfers his property so that his creditors shall not have anything out of the property, the transfer is called a fraudulent transfer. A debtor in order to defeat or delay the rights of a creditor, may transfer his property to some person, who may be his relative or a friend. The law does not allow this. Section 53 embodies the principle. It states:

"Every transfer of immoveable property made with intent to defeat or delay the creditors of the transferor shall be voidable at the option of any creditor so defeated or delayed."

Thus, where an owner of the property contracts a debt and then transfers his property to someone so that the creditor cannot proceed against the property to realise his debt, such a transfer is voidable at the option of the creditor. The transfer is valid so long as the creditor does not challenge it in a Court of law and gets a declaration that the transfer is invalid. A suit instituted by a creditor to avoid a transfer on the ground that it has been made with intent to defeat or delay the creditors of the transfer or shall be instituted on behalf of, or for the benefit of all the creditors. Once the creditor sues the debtor and says that the debtor has the intention to deceive him, the transfer can be declared invalid by the Court. The creditor has to satisfy the Court that there was an intention on the part of the debtor to defeat his rights. If he does not prove this, then the creditor will fail and the transfer is valid. The question arises as to when we can say that the transferor has the necessary intention to defeat the claim of the creditor. This can be gathered from the surrounding circumstances. Suppose a man takes a loan from the creditor. He does not pay the loan. Then the creditor sues him in a Court to get back his debt. On seeing this the debtor transfers his property to a friend of his or some other person who simply holds the property on behalf of the transferor. Again, the debtor may make a gift of his property to his wife or sell it to a friend who will afterwards retransfer the same to the transferor. Under these circumstances, we can easily say that the debtor's intention was to prevent the creditor from taking the property by a suit in the Court and to realise his debt.

But suppose the debtor has several creditors and he transfers his property to one of his creditors in satisfaction of his whole debt to him. Is this also a fraudulent transfer? The answer is No. For a mere preference of one creditor over the others is not fraudulent under the Section, even if the whole property is so transferred and nothing is left for the other creditors. But the other creditors may file a petition in the Court within three months of the transfer praying that the debtor be declared insolvent. If the debtor is adjudicated an insolvent, their interest will be protected and the transfer will be declared as fraudulent preference. The transfer will be set aside and the property will be distributed among all the creditors.

However, under Section 53(2) the rights of a transferee in good-faith and for consideration are protected. It says nothing shall affect or impair the rights of a transferee in good-faith and for consideration.

### DOCTRINE OF PART-PERFORMANCE

Lastly, we may also discuss briefly the doctrine of part-performance which is embodied in Section 53A of the Transfer of Property Act.

A contract for the sale of land has been entered into between A and B. The transferee has paid the price entering into possession and is willing to carry out his contractual obligations. As registration has not been effected A, the transferor, seeks to evict B from the land. Can he do so? No, B will not be allowed to suffer simply because the formality of registration has not been through. The legislature grants some relief to such a transferee under Section 53A, which embodies the doctrine of part-performance.

 *The rule did not exist on the statute book before 1929. Section 53A, was inserted by an amendment to the Act in 1929. Followings are the essential conditions for the operation of the doctrine of part-performance according to Section 53A.*

1. *There must be a contract to transfer immoveable property.*
2. *It must be for consideration.*
3. *The contract should be in writing and signed by the transferor himself or on his behalf.*
4. *The terms necessary to constitute the transfer must be ascertainable with reasonable certainty from the contract itself.*
5. *The transferee should have taken the possession of the property in part performance of the contract. In case he is already in possession, he must have continued in possession in part performance of the contract and must have done something in furtherance of the contract.*
6. *The transferee must have fulfilled or be ready to fulfill his part of the obligation under the contract.*

If all the abovementioned conditions are satisfied, then, the transferor and the persons claiming under him are debarred from exercising any right in relation to the property other than the rights expressly provided by the terms of the contract notwithstanding the fact that the instrument of transfer has not been registered or complete in the manner prescribed therefor by the law for time being in force. It should be noted that Section 53A does not confer any positive right on the transferee. It only prohibits exercise of the right of ownership in relation to the property in order to evict the transferee from the property because legal requirements have not been satisfied.

However, the doctrine of part-performance will not affect the right of a subsequent transferee for consideration without notice of the earlier contract and of its being partly performed.



*The right conferred by this section is a right only available to a defendant to protect his possession. This section does not create a title on the defendant. It merely operates as a bar to the plaintiff asserting his title. It is limited to cases where the transferee had taken possession, and against whom the transferor is debarred from enforcing any right other than that expressly provided by the contract. The section imposes a bar on the transferor. When the conditions mentioned in the sections are fulfilled, it debars him from enforcing against the transferee any right or interest expressly provided by the contract. So far as the transferee is concerned, the section confers a right on him to the extent it imposes a bar on the transferor (Delhi Motor Co. v. Basurkas, (1968) SCR 720).*

The English rules as to what acts constitute part-performance have been generally followed in India. These rules are as follows:

- (1) An act of part-performance must be an act done in performance of the contract. An act introductory to and previous to the agreement, cannot therefore, be act of part-performance.
- (2) The acts relied upon must be unequivocally and referable to no other contract than that alleged.
- (3) An act of part-performance must be the act of the party seeking to avail himself of the equity.

## PROPERTIES WHICH CANNOT BE TRANSFERRED

Section 6 of this Act contains some exceptions to the general rule that property of any kind may be transferred. Consequently, the following properties cannot be transferred, namely:

- (a) the chance of an heir apparent succeeding to an estate, the chance of a relation obtaining a legacy on the death of a kinsman or any other mere possibility of a like nature cannot be transferred.

- (b) A mere right of re-entry for breach of a condition subsequent cannot be transferred to any one except the owner of the property affected thereby.
- (c) An easement cannot be transferred apart from the dominant heritage.
- (d) An interest in property restricted in its enjoyment to the owner personally cannot be transferred by him.
- (e) A right to future maintenance in whatsoever manner arising, secured or determined, cannot be transferred.
- (f) A mere right to sue cannot be transferred.
- (g) A public office cannot be transferred nor can the salary of a public officer, whether before or after it has become payable.
- (h) Stipends allowed to military, naval, air force and civil pensioners of the Government and political pensions cannot be transferred.

**(a) Chance of an heir apparent or 'Spes Successionis'**

In this clause possibilities referred are bare or naked possibilities and not coupled with an interest such as contingent remainders or future interest-also known as right of spes successionis which cannot be the subject to transfer.

When a person is the owner of property, the property is in existence and it is in his possession. This he may transfer. But if property is neither in existence nor is the person the owner of the property then it cannot be transferred. For example, if a person is intending to buy certain property but, he has no interest in that property, he cannot transfer it unless the property comes to his hands, i.e., unless he becomes the owner of the property after buying it. But if a person obtains certain consideration and agrees to sell the property of which he is not the owner, then on becoming the actual owner of the property he has to transfer the property as there was a contract between him and the person who has agreed to buy the property. This transfer operates on a contract to be performed when the property comes into the hands of the person who has agreed to transfer. But where a person wants to make a gift of the property which is to come in his hands in future, he cannot transfer it because a gift is voluntary transfer without any consideration. Thus a gift of future property is void. Similarly, the chance of a heir apparent succeeding to the estate of a deceased person cannot be transferred. Suppose A is the owner of the property and B is his son. B is the heir of A. During the life time of his father A, B has only a hope expectancy that he will inherit the property of his father. This type of property which B hopes to get after the death of the father cannot be transferred, during the life time of A.

**Illustrations:**

- (a) Suppose A, a Hindu who has separate property, dies leaving a widow W and a brother L, L's succession to the property is dependent upon two factors, viz., (i) his surviving the widow, W, and (ii) W leaving the property intact. L has only a bare chance of succession to the property left by A. This is spes successionis, and therefore, cannot be transferred (Amrit Narayana v. Gyan Singh, (1918) 45 Cal. 690).
- (b) A transfers to B for valuable consideration his reversionary interest in a property. When A succeeds to the property, B sues him for possession of the same. B will not succeed as the reversionary interest is a spes successionis and non-transferable. So the transfer is void and B's suit for possession fails.

**(b) Right of re-entry**

The right which the lessor has against the lessee for breach of an express condition which provides that on its breach the lessor may re-enter is called the right of re-entry. For instance, if A leases his property to B and adds a condition that if B sub-lets the leased land, A will have the right to re-enter, i.e., the lease will terminate if the lessee breaks the condition by subletting to a third person. Thus, right of re-entry being a right for the personal benefit of any party cannot exist for the benefit of a person who has no personal interest in the land. For example, A grants his land by way of lease to B, a limited liability company on condition that the land should revert to A from B if the company goes into liquidation. This is a mere right in favour of A and this right A cannot transfer to anyone as this is a personal right which can be exercised by A only. But if A transfers the whole of his interest in the land including the right of re-entry to C, there the right to re-entry is a legal incident of property and can be validly transferred along with the property.

### (c) Transfer of easement

An easement is a right enjoyed by the owner of land over the land of another: such as, right of way, right of light, right of support, right to a flow of air or water. Section 4 of the Easements Act defines an easement as a right which the owner or occupier of certain land possesses as such for the beneficial enjoyment of the land, to do and continue to do something or to prevent and to continue to prevent something being done in or upon or in respect of certain other and not his own land. An easement includes a right to enjoy a profit out of the land of another. An easement exists for the accommodation and better enjoyment of the land to which it is annexed. The land owned by the possessor of the land is known as dominant tenement and the land over which the right is enjoyed is known as the servient tenement.

It may be noted, however, that the prohibition is only with regard to transfer of an existing easement. The law does not prohibit the grant or creation of new easement (*Bhagwan Sahai v. Narsing*. (1909) 31 ALL. 612; *Satyanarayana v. Lakshamaya* 5 H.L.J. 56 or the extension of an easement by release in favour of the owner of servient tenement).

As an easement confers no proprietary right on its owner, it cannot be transferred apart from the land itself. For example, the right of certain villagers to bath in another's tank cannot be transferred. Similarly if A, the owner of a house X, has a right of way over an adjoining plot of land belonging to B, he cannot transfer this right of way to C. But if he transfers the house itself to C, the easement is also transferred to C.

### (d) Restricted interest or personal interest

An interest restricted in enjoyment to the owner personally is by its very nature not transferable unless the restriction is void under Section 10. Examples of such restricted interest or property are the following:

- (i) The right of pre-emption given under the Mohammedan Law.
- (ii) The office of a Shebait of a Temple or mohunt of a mutt or mujuwalli of a wakf.
- (iii) Emoluments attached to a priestly office.
- (iv) Service tenures.

### (e) Right to future maintenance

This again is a personal right in the property which the law says that it cannot be transferred. The right of a Hindu widow to maintenance is a personal right which cannot be transferred. Under the law the arrears of past maintenance can be transferred, but not the right to future maintenance.

### (f) Mere right to sue and actionable claim

A 'mere right to sue' apart from the interest from which such right accrues cannot be assigned. The 'right to sue' is a personal right annexed to the ownership of property and cannot be severed, from it. It is based on the principle of public policy to prevent multiplicity of suits; the object is mainly to prevent the abuse resulting from trafficking in litigation.

The use of the word "mere" is significant. The question in every case is whether the subject-matter of transfer is property with an incidental remedy for its recovery or is a 'mere' right to 'sue'. Where property is transferred along with a right to recover damages or compensation in respect of the property, the assignment is not hit by clause (4) of Section 6 of the T.P. Act.

A mere right to sue cannot be transferred. The right refers to a right to damages arising both out of contracts as well as torts. For example, A commits an assault on B, B can file a suit to obtain damages; but B cannot assign the right to C and allow him to obtain damages. In contract also, the rule is the same. If A breaks a contract which he has entered into with B, B can bring action for damages, but B cannot transfer this right to C to recover damages.

There is clear distinction between an actionable claim and a mere right to sue. An actionable claim is property and the assignee has a right to sue to enforce the claim.

As already noted a right to recover an unascertained amount of damages resulting from breach of contract or tort is a mere right to sue. If, however, one has a right to recover an ascertained and definite debt, he may transfer it because it is an actionable claim. Thus, suppose A is indebted to B for Rs. 2,000 and B transfers the right to recover the debt of C, the transfer is void. A beneficial interest in specific moveable property is also an actionable claim. It has been held that the right to claim the benefit of an executory contract constitutes a beneficial interest in moveable property (*Jaffer Meher Ali v. Budge Budge Jute Mills*, (1900) 33 Cal. 702).

After breach of a contract for the sale of goods nothing is left but a right to sue for damages which cannot be transferred. But before breach the benefit of an executing contract for the sale of goods may generally be transferred and the buyer has the right to sue for the goods.

### **(g) Transfer of public office and salaries, stipends, etc.**

It is against public policy for a public officer to transfer the salary of his office, for the salary is given for the purpose of upholding its dignity and the proper performance of its duties. Civil and military pensions are not transferable. A pension retains its character as long as it is unpaid and is in the hands of Government, but as soon as it is paid to the pensioner or his legal representatives, it can be transferred. Since these allowances, pensions and stipends are given on personal basis, the law does not allow these types of property to be transferred.

### **RULE AGAINST PERPETUITY**

Section 14 of the Act provides that no transfer of property can operate to create an interest which is to take effect after the life time of one or more persons living at the date of such transfer, and the minority of some person who shall be in existence at the expiration for that period, and to whom, if he attains full age, the interest created is to belong.

The rule against perpetuity is based on the general principle that the liberty of alienation shall not be exercised to its own destruction and that all contrivances shall be void which tend to create a perpetuity or place property forever out of the reach of the exercise of the power of alienation. Perpetuity has been described as "exemptions from intermission or ceasing". This has been said to be "odious in law, destructive to the commonwealth, and an impediment to commerce, but preventing the wholesome circulation of property".

A perpetuity in the primary sense of the word, "is a disposition which makes property inalienable for an indefinite period" (Jarman on Wills, 8th ed., vol. 1, P. 284). Section 14 of the Act adopted with certain modifications the English rule against perpetuities which is enunciated by Jarman as "Subject to the exceptions to be presently mentioned, no contingent or executory interest in property can be validly created, unless it must necessarily vest within the maximum period of one or more lives in being and twenty-one years afterwards". Section 14 of the Act fixes the perpetuity period as: Life (or Lives) living at the time of transfer and actual minority of the then unborn ultimate transferee.

Any number of successive estates can be created between the transferees who are living persons e.g. A transfer may be made to A for life and then to B for life and then to C for life and so on, provided that A, B and C are all living persons at the date of the transfer. But if the ultimate beneficiary is some one who is not in existence at the date of the transfer, the whole residue of the estate should be transferred to him. If he is born before the termination of the last prior estate, he takes a vested interest at birth and takes possession on the termination of the last prior estate but if he is not born till the termination of the last prior estate, the transfer to him fails.

Further, the rule is not that vested interest is created at the birth of the beneficiary but that vested interest cannot be delayed in any case beyond his minority. Therefore, the rule against perpetuity is that the minority of the ultimate beneficiary is the latest period at which an estate can be made to vest.

In India minority terminates at the end of 18 years.

The rule against perpetuities applies to both moveable and immoveable property.

Thus, the rule against perpetuity contains two propositions, i.e.:

No transfer is valid after the life-time of one or more persons living at the date of such transfer. Transfer can remain in effect only during the life time of an existing person

Transfer can be extended to a person who is not in existence but if he is in existence at the time of termination of the period of last transfer. The moment the person is born he shall have contingent interest and after minority i.e. after the age of 18 years, he shall have vested interest. Barring these two conditions, a restriction on alienation of a property is void

However, Section 18 provides an exception to the above rule of perpetuity, where the transfer of property is for the benefit of the public in the advancement of religion, knowledge, commerce, health, safety, or any other object beneficial to mankind.

### Effect of a transfer on failure of prior interest

Further, where by reason of any rules or the rules contained in Sections 13 and 14, interest created for the benefit of a person or class of persons fails in regard to such person or the whole of such class, any interest created in the same transaction and intended to take effect or upon failure of such prior interests also fail (Section 16). For example, property is transferred to A for life then to his unborn son B for life and then to C, who is living at the date of transfer, absolutely. Here B is given only a life interest. So the transfer to B is invalid under Section

The subsequent transfer to C absolutely is also invalid, because according to Section 16, if a prior transfer fails, the subsequent transfer will also fail.

No transfer of property can operate to create an interest which is to take effect after the life time of one or more persons living at date on such transfer, and the minority of some person who shall be in existence on the expiration of that period, to whom, if he attains full age, the interest created is to belong.

The policy of the law has been to prevent property being tied up for ever. The vesting cannot be postponed beyond the life time of any person living at the date of transfer. For example, if an estate is given to a living person A for life and then to the unborn son of A, the son of A must be in existence on or before the date of the expiry of the life estate in favour of A. The vesting of absolute interest in favour of an unborn person may be postponed until he attains majority. For example, an estate may be transferred to A, living person, and after his death to his unborn son when he attains the age of 18. Such transfer would not be violative of the rule against perpetuity.

### ACCUMULATION OF INCOME

Section 17 does not allow accumulation of income from the land for an unlimited period without the income-being enjoyed by owner of the property. The law allows accumulation of income for a certain period only. The period for which such accumulation is valid is :

- (a) the life of the transferor, or
- (b) eighteen years from the date of transfer.

Any direction to accumulate the income beyond the period mentioned above is void except where it is for:

- (i) the payment of the debts of the transferor or any other person taking any interest under the transferor,
- (ii) portions for children or any other person taking any interest in the property under the transfer, and
- (iii) for the preservation and maintenance of the property transferred.

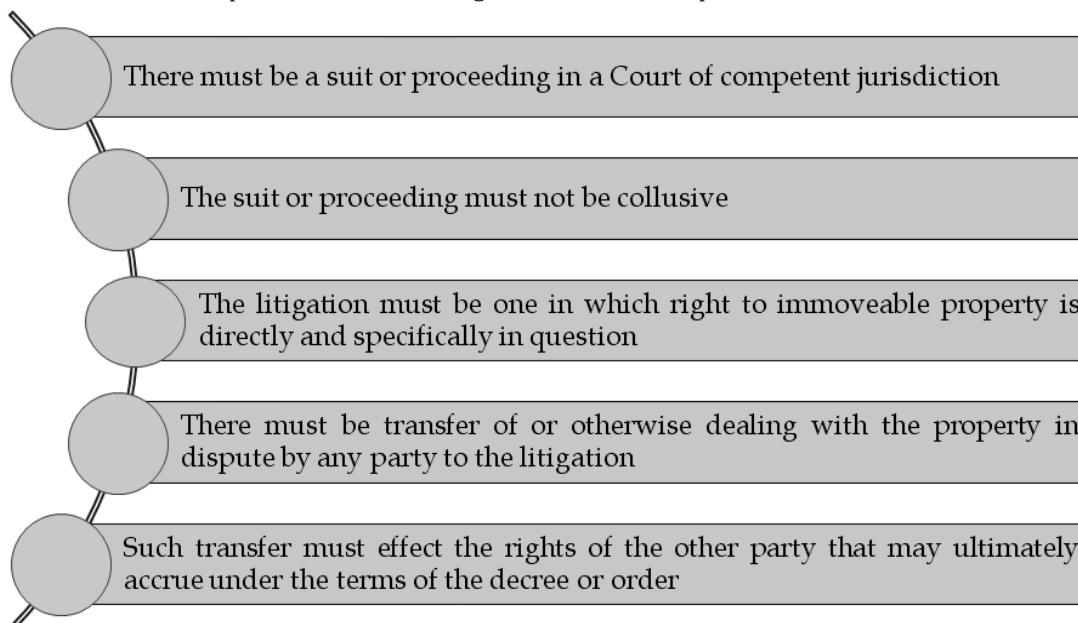
## DOCTRINE OF LIS PENDENS

Lis means dispute, Lis pendens means a pending suit, action, petition or the like. Section 52 of the T.P. Act incorporates the doctrine of Lis pendens. It states that during the pendency of a suit in a Court of Law, property which is subject to a litigation cannot be transferred. When we say that property cannot be transferred what we mean in this context is that property may be transferred but this transfer is subject to the rights that are created by a Court's decree. For example, A and B are litigating in a Court of law over property X and during the pendency of the suit A transfers the property X to C. The suit ends in B's favour. Here C who obtained the property during the time of litigation cannot claim the property. He is bound by the decree of the Court wherein B has been given the property.

Section 52 lays down the Indian rule of Lis pendens being the legislative expression of the Maxim- "ut lite pendente nihil innovetur" 'During litigation nothing new should be introduced'.

### Essentials

In order to constitute a Lis pendens, the following elements must be present:



The rule is based on the doctrine of expediency i.e., the necessity for final adjudication. A plea of lis pendens will be allowed to be raised even though the point is not taken in the pleadings or raised as an issue.

When an application to sue in forma pauperis is admitted, the suit is pending from the time of presentation of the application to the Court but not if it is rejected.

A suit in foreign Court cannot operate as lis pendens. The doctrine of lis pendens does not apply to moveables. It is the essence of the rule that a right to immoveable property is directly and specifically in question in the suit. The doctrine is not applicable in favour of a third-party.

### Effect

If the parties to the litigation, are completely prevented from transferring the property in litigation, it would cause unnecessary delay and hardship, as they would have to wait till the final disposal of the case. So, Section 53 creates a limitation over the transfer by making it subject to the result of the litigation. The effect of this doctrine is not to invalidate or avoid the transfer, or to prevent the vesting of title in the transfer, but to make it subject to the decision of the case, and the rule would operate even if the transferee pendente lite had no notice of the pending suit or proceeding at the time of the transfer.

## PROVISIONS RELATING TO SPECIFIC TRANSFERS

The Act expressly provides for special types of transfers such as sale, exchange, gift, mortgage and lease.

These are as follows:

In a sale, exchange and gift, there is a transfer of the ownership of property but mortgage is a transfer of an interest in specific immoveable property and lease is a transfer of the right to enjoy immoveable property.

### 1. Sale

 Under Section 54 of the T.P. Act, "sale" has been defined as a transfer of ownership in exchange for a price paid or promised or part paid and part-promised.

#### Essentials

- The seller must be a person competent to transfer. The buyer must be any person who is not disqualified to be the transferee under Section 6(h)(3).
- The subject matter is transferable property.
- There is a transfer of ownership. This feature distinguishes a sale from mortgage, lease etc., where there is no such transfer of ownership.
- It must be an exchange for a price paid or promised or part paid and part promised.
- There must be present a money consideration. If the consideration is not money but some other valuable consideration it may be an exchange or barter but not a sale.

### Mode of transfer by sale

Sale of an immoveable property can be effected,

- Where such property is tangible (i) by a registered instrument if it is of the value of Rs. 100 and upwards, and (ii) by a registered instrument or by delivery of property when it is less than Rs. 100 in value, and
- Where the property is tangible or a reversion, only by a registered instrument.

### Contract for sale

A contract for the sale of immoveable property differs from a contract for the sale of goods in that the Court will grant specific performance of it unless special reasons to the contrary are shown.

The rights and liabilities of a seller and buyer are dealt with in Section 55 of the Transfer of Property Act.

### 2. Exchange

 Sections 118 to 121 of the Transfer of Property Act, 1882 deal with "Exchanges".

*When two persons mutually transfer the ownership of one thing for the ownership of another, neither thing or both things being money only, the transaction is called an "exchange".*

#### Essentials

- The person making the exchange must be competent to contract.
- There must be mutual consent.
- There is a mutual transfer of ownership though things and interests may not be identical.
- Neither party must have paid money only.

This Section applies to both moveable and immoveable property.

## Mode of exchange

A transfer of property in completion of an exchange can be made only in the manner provided for the transfer of such property by sale.

### 3. Gift

The provisions relating to "Gifts" have been stipulated under Sections 122 to 128 of the Act. Section 122 of the Transfer of Property Act defines "gift" as follows:

 "Gift" is the transfer of certain existing moveable or immoveable property made voluntarily and without consideration by one person called the donor, to another called the donee and accepted by or on behalf of the donee.

Such acceptance must be made during the life time of the donor and while he is still capable of giving. If the donee dies before acceptance, the gift is void.

#### Essentials

1. There must be a transfer of ownership.
2. The subject matter of gift must be a certain existing moveable or immoveable property.
3. The transfer must be made voluntarily.
4. It must be done without consideration.
5. There must be acceptance by or on behalf of the donee, and such acceptance must be made during the lifetime of the donor and while he is capable of giving.

There are two parties to the gift: donor and donee. The donor must be a person competent to transfer; whereas the donee may be any person. The gift can be made to any one, to an incompetent person or even to a juridical person. The essence of a gift is that it is a gratuitous transfer.

According to Section 123, a gift of immoveable property must be made by a registered instrument signed by or on behalf of the donor and attested by at least two witnesses. A gift of moveable property may be made by a registered instrument or by delivery of property. Where the donee is already in possession of the moveable property, as no future delivery is possible, the donor may make a declaration of the gift in his favour. For example, where a piece of furniture or a television set belonging to the donor is lying with a friend of his, the donor may simply declare that he makes a gift of the furniture or the television set and the gift is complete. The declaration must be clear and the donee must accept the gift.

A gift of immoveable property, as said above, must be effected by registration. Where a gift in favour of someone is registered but it is not accepted by the donee, the gift is incomplete. Suppose, a document is executed by the donor who makes a gift of immoveable property and the deeds are delivered to donee, and the donee accepts the gifts but the document is not registered. Will the gift be valid? It has been held by the Courts that the gift is valid. While registration is a necessary formality for the enforcement of a gift of immoveable property, it does not suspend the gift until registration actually takes place. The donee in such a case can ask the donor to complete the gift by registration. Thus, the most essential thing for the validity of a gift is its acceptance. If the gift is accepted but not registered it is a valid gift. The Privy Council in *Kalyan Sundram v. Kumarappa*, A.I.R. 1925 P.C. 42, decided that after acceptance of the deed of gift and before registration, the donor cannot revoke the gift. The gift which is accepted by the donee, will take effect from the date of the execution of the document by the donor, even though it is registered at a later date.

If the deed of gift is executed but never communicated to the intended donee and remains in the possession of the donor undelivered, it cannot be compulsorily registered at the instance of the donee. The reason is that the donee did not accept the gift, the donor can at any time before such acceptance revoke the gift. But once a gift is accepted by the donee, the donor cannot revoke it. A gift may, however, be revoked if it is brought about by a fraud or misrepresentation or undue influence.

The other essential characteristic of a gift is that it cannot be revoked at the will and pleasure of the grantor. A revocable gift is one which may be revoked by the donor at any time. Its revocation would depend upon the mere will or pleasure of the donor. Such a gift is void. But on the other hand, if the condition is one which does not depend on the will or pleasure of the donor, the gift can be revoked on the happening of such condition.

### Illustrations

- (a) A gives a field to B, reserving to himself, with B's assent, the rights to take back the field in case B and his descendants die before A, B dies without descendants during A's lifetime. A may take back the field.
- (b) A gives a lakh of rupees to B, reserving to himself with B's assent the right to take back at leisure Rs. 10,000 out of one lakh. The gift holds goods as to Rs. 90,000 but is void as to Rs. 10,000 which continues to belong to A.

A gift which comes into existence on the fulfilment of a condition, that is to say, a gift which is subject to a condition precedent is also valid. A condition precedent, as already explained in this study dealing with vested interest and contingent interest, is one which must be fulfilled before the transfer takes effect. But the condition attached to the gift should not be illegal or immoral. For instance, a gift to A on condition that he murders B is not valid.

A gift comprising both of existing property and future property is void as to the latter. For example, A makes a gift of his house and also makes a gift of the additions that he is likely to make in future. Here the gift of the house is valid but the gift of the additions that are yet to be made is invalid.

**Onerous gift:** Lastly reference may also be made to what is known as an onerous gift. It may be that several things are transferred as a gift by single transaction. Whereas some of them are really beneficial the others convey burdensome obligations. The result is that the benefit which it confers is more than counter balanced by the burden it places. For instance, A makes a gift of shares in the companies X and Y. X is prosperous but heavy calls are expected in respect of shares in Y company. The gift is onerous. The rule as laid down in Section 127 is that the donee takes nothing by the gift unless he accepts it fully. Where the gift is in the form of two or more independent transfers to the same person of several things, the donee is at liberty to accept one of them and refuse the other.

The rules pertaining to gifts in the Transfer of Property Act do not apply to the gifts by Mohammedans. If a gift is made by a Mohammedan, its validity has to be judged according to Muslim law and not according to the Transfer of Property Act.

### 4. Leases



(i) *Meaning and nature of lease:* According to Section 105, a "lease" of immoveable property is a transfer of a right to enjoy property. Since it is a transfer to enjoy and use the property, possession is always given to the transferee. The lease of immoveable property must be made for a certain period. For example, you may give a lease of property for a definite number of years, or for life, or even permanently.

### Essentials

The essentials of a lease are:

- (1) It is a transfer of a right to enjoy immoveable property;
- (2) Such transfer is for a certain time or perpetuity;
- (3) It is made for consideration which is either premium or rent or both;
- (4) The transfer must be accepted by the transferee.

The transferor is called the lessor, the transferee is called the lessee, the price is called premium and the money, share, service or any other thing of value to be so rendered is called the rent.

The parties to the lease (i.e. lessor and lessee), must be competent to make and to take the lease respectively.

*(ii) Lease and licence:* A lease should be distinguished from a licence. A licence is a right to do or continue to do in or upon the immoveable property of the grantor, something which would, in the absence of such a right, be unlawful.

A licence does not transfer any interest in the property and the licensee has no right to possession. A licence can be revoked by the grantor at any time, whereas a lease cannot be revoked. If, I sell the fruits of my garden to you, you are given permission or licence to enter my garden and take away the fruits. A lease involves a transfer of interest followed by possession of the property for a specified period. The real test is the intention of the parties.

If the document creates an interest in the property, it is a lease but if it only permits another to make use of the property of which the legal possession continues with the owner, it is a licence because it does not create any interest in that property (*Associated Hotel of India v. R.N. Kapoor, A.I.R. (1956) S.C. 1962*).

The question is not of words but of substance and the label which the parties choose to put upon the transaction though relevant is not decisive.

*(iii) Formalities:* According to Section 107, a lease from year to year or for any term exceeding one year can be made only by a registered document. If a lease is for a term below one year, it can be made by an oral agreement. If a lease is created by oral agreement, it must be accompanied by delivery of possession. If the lease is for a year or more, it must be effected by a registered document. If after the registration, the lessor does not give possession, the lessee can sue for possession.

*(iv) Types of tenancies:* Following are the various types of tenancies:

- (a) **Tenancy from year to year:** A tenancy from year to year may be made by a grant of land from year to year. If the tenancy is for a year to start with but after the expiration of one year the lessee continues to be in possession and pays the rent to the landlord, the tenancy is regarded as a year-to-year tenancy. If, in case of a tenancy for a period more than a year the landlord wants to terminate or end the lease, he has to give a six-month's notice to the lessee to quit. In case of a tenancy from month to month, a fifteen days notice to quit is necessary. The monthly tenancy may be created either by contract or may be presumed from the nature of the tenancy to be one, from month to month.
- (b) **Tenancy-at-will:** Tenancy-at-will is a tenancy recognised by law. This comes into existence where a tenant holds over with the consent of the landlord into occupation. We have stated above that if the tenant continues to be in possession after the expiration of tenancy and pays the rent to the landlord, the tenancy may be one from year to year or from month to month. During a period when the tenant is in possession after expiry of the period, if the tenant stays with the consent of the landlord till such time as further period is fixed or a fresh contract is made, the tenant is called a tenant-at-will. The landlord will decide for what further period shall the tenancy be given. A tenancy-at-will is implied when a person is in possession by the consent of the owner and is not held in view of any tenancy for a certain time. The tenancy-at-will does not mean that the landlord has to give a proper notice to quit. The tenant-at-will cannot sublet during that period because no valid contract for further extension in his favour has been made. The death of the landlord or tenant determines the tenancy, i.e., the tenancy comes to an end.
- (c) **A tenancy by sufferance:** This is a tenancy which is created by fiction of law. If a tenant continues to be in possession after the determination of the period of the lease without the consent of the landlord, he becomes a tenant by sufferance. A tenant-at-will is in possession with the consent of the landlord, whereas a tenant by sufferance is in possession without his permission after the term of the lease comes to an end. This type of tenant is not regarded as a trespasser because the tenant had in his favour a valid lease to start with. No notice is necessary to such a tenant for eviction. This tenant is not responsible for rent. He is liable to pay compensation for use and occupation of the land.
- (v) **Requirements of a valid notice:** In order that a notice to quit is valid it must be a proper notice. The notice must convey the intention to terminate the tenancy as a whole and must specify the date on which the tenancy would expire. As mentioned earlier, if the lease is a lease from month to month, 15 days, notice is required. If it is from year to year 6 months' notice is required. A lease of the moveable property for agricultural or manufacturing purposes shall be deemed to be a lease from year to year. The notice should expire with the end

of the period of the tenancy. If it is a lease from month to month and the notice is given by the landlord, the tenant should be asked to quit at the end of the month of the tenancy. The landlord cannot ask his tenant to quit at any time before the expiry of a month or a year of the tenancy.

*(vi) Determination of leases:* Section 111 of the Transfer of Property Act spells out the various contingencies in which a lease comes to an end. A lease is determined, i.e., comes to an end in the following ways:

- (1) By efflux of time or lapse of time: A lease for a definite period, such as a lease for a year, or for a term of years, expires on the last day of the term and the lessor or any person entitled to get back the property may enter without notice or any other formality. Since a lease is a transfer of interest in the property, if during the period for which a lease is valid, the lessee dies, the heirs of the lessee can continue the lease till the expiry of the period.
- (2) By the happening of a special event: When a lease is granted subject to the happening of an event, it comes to an end when the event takes place. Thus, if B grants lease to A for life, it comes to an end on the death of A. Similarly, if a lease is granted for the duration of the war, it comes to an end when the war ends. Where the interest of the lessor is limited, the lease comes, to an end when he loses the interest or where he does not have any power to grant a lease. For example, a tenant for life can grant a lease only to last during his life time. It comes to an end on his death.
- (3) Merger: A lease comes to an end when the lessee buys the property of the lessor or when the lessee takes the lessor's interest by succession. Here the right of the lessee merges in that of the lessor. Naturally, the lessee becomes the owner of the property after he acquires it. So there will be no more a lease.
- (4) By surrender: A lease may come to an end by surrender. Surrender may be either express or implied. Express surrender arises when the lessee yields up his interest under a lease by mutual consent. Implied surrender occurs, as follows :- if during the subsistence of the lease, a new lease is granted to the tenant to commence at once in substitution for the existing lease, it operates as a surrender of the old lease. For example, a lessee, accepts to take effect during the continuance of the existing lease. This is an implied surrender of the former lease and such lease comes to an end. Similarly, when the landlord reserves possession without any objection on the tenant's part, there is a surrender by implication. Mere non-payment of rent does not amount to surrender.
- (5) By forfeiture: A lease also comes to an end by forfeiture. A forfeiture occurs when there is breach of a condition in a lease contract by the lessee. Under the Transfer of Property Act, forfeiture occurs in the following circumstances—the first case in which forfeiture occurs is the case when the lessee breaks an express condition which may be of various types such as, if the lessee does not pay the rent regularly, or if the lessee becomes insolvent, or where the lessee sublets the property to another person. In all such cases there will be a forfeiture. But the condition that the lessee breaks must be an express condition which must have been incorporated in the contract of lease. Then only the lessor can re-enter the leased property and claim that the lease shall be forfeited.

In the case of a forfeiture due to default in payment of the rent, if the lessor sues the lessee to quit, the Court can direct the lessee to pay the rent or arrears of rent and continue the lease. But in a breach of any other condition, such as the breach of a condition preventing the lessee from subletting the property, the Court will not help the lessee if he breaks the condition. He will incur forfeiture. A breach of condition by the lessee gives an option to the lessor to bring the lease to an end. But if he does not exercise the option the lease will continue validly. The lessee, however, cannot on breaking the condition, take advantage of his wrong and terminate the lease.

The second case of forfeiture occurs when the tenant denies the title of the landlord and claims that somebody else or he himself is the owner of the property. In order that a denial of the landlord's title should work as a forfeiture of the lease, three things are necessary:

- (a) the tenant must set up title either in himself or in a third-party;
- (b) the denial must be direct and not casual;
- (c) it must be made known to the landlord.

(vii) *Duties of the Lessor: Following are some of the duties of the lessor:*

- (a) The lessor is bound to disclose to the lessee any material defect in the property with reference to its intended use of which the lessor is and the lessee is not aware. This rule applies only to physical defects of the property such as the condition and the nature of the property leased. You will note that the lessor is not bound to disclose whether or not he has title to the property.
- (b) The next duty of the lessor is to put the lessee in possession of the property. A lease is a transfer of possession the consideration being rent and, therefore, it follows that the landlord cannot recover the rent unless he has delivered possession to the tenant. If a contract of lease has been executed and the lessor does not give possession of the property to the lessee, the lessee can sue the lessor for possession.
- (c) The next duty that is cast on the lessor is what is usually called covenant for quiet enjoyment. The covenant, that is the right to undisturbed possession, so long as the lessee pays the rent, presupposes possession and, therefore, no action can be brought on this covenant unless the lessee has first obtained possession. The covenant for possession gives the lessee the right to obtain possession; the covenant for quiet enjoyment gives the lessee a right to continue in such possession. If the lessee's possession is disturbed, he can sue for damages or, in case a part of the leased property is taken possession of either by the lessor or by any third-party; the lessee can hold a part of the leased property and pay a proportionate rent.

(viii) *Duties of the lessee: The lessee has the following duties:*

- (a) The lessee is bound to disclose to the lessor any fact as to nature or extent of the interest that the lessee is about to take, of which the lessee is, and the lessor is not aware and which materially increases the value of such interest.
- (b) The lessee is bound to pay or tender at the proper time and place, the premium or rent to the lessor or his agent in this behalf. We have already seen that in case the lessee does not pay the rent, he may incur forfeiture of the tenancy. The liability to pay the rent commences from the date the tenant is put into possession.
- (c) The next duty of the lessee is that he uses the property as a person of ordinary prudence would make use of. But he shall not permit another person to use the property for purposes other than that for which it was leased.
- (d) He should not do any act which is destructive of or permanently injurious to the property.
- (e) The lessee must not, without the lessor's consent, erect on the property any permanent structure except for agricultural purpose. If he wants to erect certain fixtures or chattel on the leased property, it must be done without causing any damage to the property. Before the termination of the lease, he can remove all the things attached to the earth. If permanent fixtures are to be made, the lessee must obtain the consent of the landlord.
- (f) If the lessee comes to know of any proceedings by way of suit to recover the property of the lessor, the lessee should immediately inform the lessor. Since, the tenant is in possession of the property he is the person who is not likely to know of any encroachment on the landlord's property and he should therefore inform the landlord.
- (g) The lessee should hand over the property at the end of the lease.

(ix) *Rights of the lessee: The lessee enjoys the following rights:*

- (a) If during the continuance of the lease any accession is made to the property, such accession is deemed to be comprised in the lease, the lessee has a right to enjoy the accretions of the leased property.
- (b) Where, under the contract, the landlord has agreed to repair the property, the lessee can carry out the repairs and deduct the expenses from the rent if the landlord fails to do so.
- (c) If the lessee has made payment which the lessor is bound by law to pay such as payment of Government revenues or municipal taxes on the property, the lessee can deduct the amount from the rent and pay the balance to the lessor. He can even take interest on the amount he has paid.

- (d) The lessee has a right to remove the fixtures he has erected during the term of the lease.
- (e) If, due to no fault of his, the lease comes to an end (i.e., when the lease is of uncertain duration), the lessee or his legal representatives are entitled to all the crops planted or grown by the lessee. The lessee or his representatives have got a right to come and carry away the crops, etc., which are growing on the land. If the lease is of a definite period, such a right cannot be claimed, particularly, when lessee has committed a fault, e.g., where he has committed a breach of a condition entailing forfeiture.
- (f) The lessee may avoid the lease, if property is wholly or partly destroyed by tempest, flood, or fire so as to make it impossible to continue the lease for the purpose for which it was let.
- (g) The lessee has right to transfer absolutely or by way of mortgage or sub-lease, the whole or any part of his interest in the property. We have also noticed that the lessee's rights are transferable.

## 5. Actionable Claims

"Actionable claim" has been dealt with under Sections 130 to 137 of the Act.

- (i) Definition: "Actionable claim" is defined in Section 3 of the Transfer of Property Act as follows:

A claim to any debt, other than a debt secured by mortgage of immoveable property or by hypothecation or pledge of moveable property, or to any beneficial interest in moveable property not in the possession, either actual or constructive, of the claimant, which the Civil courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent.

Actionable claims are claims, to unsecured debts. If a debt is secured by the mortgage of immoveable property it is not an actionable claim, because the Section clearly excludes such a debt. A debt is a liquidated money obligation which is usually recoverable by a suit. To create a debt, first of all, there must be a liquidated or definite sum which is actually due. For example, arrears of rent due. The term debt may also include a sum of money which is due in the sense that it exists, but is not actually payable until a later date. For example, A borrows money from B on the 1st of January and promises to repay on March 15, the amount is not payable till the 15th of March, but certainly it is a debt and it is an accruing debt. Another essential of an actionable claim is that it is not in possession of a person and the person can claim such a debt by bringing an action in a Court of law.

The Section also says that it must be a claim to any debt which the Civil Courts recognise as affording grounds for relief to the person who claims it.

### Illustrations of actionable claims:

- (i) Arrears of rent accrual constitute a 'debt' so it is an actionable claim (Sheu Gobind Singh v. Gauri Prasad, AIR 1925 Pat. 310).
- (ii) Provident Fund that is standing to the credit of a member of the Provident Fund.
- (iii) Money due under the Insurance Policy.
- (iv) A partner's right to sue for accounts of dissolved partnership is an actionable claim being a beneficial interest in moveable property not in possession (Thakardas vs. Vishindas).

## Non-actionable claims

- (i) Debentures are secured debts and therefore not regarded as actionable claims.
- (ii) Copy right though a beneficial interest in immoveable property is not an actionable claim since the owner has actual or constructive possession of the same (Savitri Devi v. Dwarka Bhatya, (1939) All 305).

Again, an actionable claim includes a beneficial interest in the moveable property not in possession. Now, a benefit of a contract for the purchase of goods is a beneficial interest in moveable property.

## 6. Mortgages

Sections 58 to 104 of the Act deal with "Mortgages".

### *Definition and nature of mortgage:*

According to Section 58 of the Transfer of Property Act, a "mortgage" is the transfer of an interest in specific immoveable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt or the performance of an engagement which may give rise to pecuniary liability.

The transferor is called a mortgagor, the transferee a mortgagee. The principal money and interest the payment of which is secured for the time being are called the mortgage money and the instrument by which the transfer is effected is called a mortgage deed.

### *Essentials of a mortgage:*

- (1) Transfer of interest: The first thing to note is that a mortgage is a transfer of interest in the specific immoveable property. The mortgagor as an owner of the property is possessed of all the interests in it, and when he mortgages the property to secure a loan, he only parts with an interest in that property in favour of the mortgagor. After mortgage, the interest of the mortgagor is reduced by the interest which has been transferred to the mortgagee. His ownership has become less for the time being by the interest which he has parted with in favour of the mortgagee. If the mortgagor transfers this property, the transferee gets it subject to the right of the mortgagor to recover from it what is due to him, i.e., the principal plus interest.
- (2) Specific immoveable property: The second point is that the property must be specifically mentioned in the mortgage deed. Where, for instance, the mortgagor stated "all of my property" in the mortgage deed, it was held by the Court that this was not a mortgage. The reason why the immoveable property must be distinctly and specifically mentioned in the mortgage deed is that, in case the mortgagor fails to repay the loan the Court is in a position to grant a decree for the sale of any particular property in a suit by the mortgagee.
- (3) To secure the payment of a loan: Another characteristic of a mortgage is that the transaction is for the purpose of securing the payment of a loan for the performance of an obligation which may give rise to pecuniary liability. It may be for the purpose of obtaining a loan, or if a loan has already been granted to secure the repayment of such loan. There is thus a debt and the relationship between the mortgagor and the mortgagee is that of debtor and creditor. When A borrows 100 bags of paddy and further quantity by way of interest, it is mortgage transaction for the performance of an obligation.

Where, however, a person borrows money and agrees with the creditor that till the debt is repaid he will not alienate his property, the transaction does not amount to a mortgage. Here the person merely says that he will not transfer his property till he has repaid the debt; he does not transfer any interest in the property to the creditor. In sale as distinguished from a mortgage, all the interest or rights of ownership are transferred to the purchaser. In a mortgage, as stated earlier, only part of the interests are transferred to the mortgagee, some of them remaining vested in the mortgagor.

To sum up, it may be stated that there are three outstanding characteristics of a mortgage:

- (a) the mortgagee's interest in the property mortgaged terminates upon the performance of the obligation secured by the Mortgage.
- (b) the mortgagor has a right of foreclosure upon the mortgagor's failure to perform.
- (c) the mortgagor has a right to redeem or regain the property on repayment of the debt or performance of the obligation.

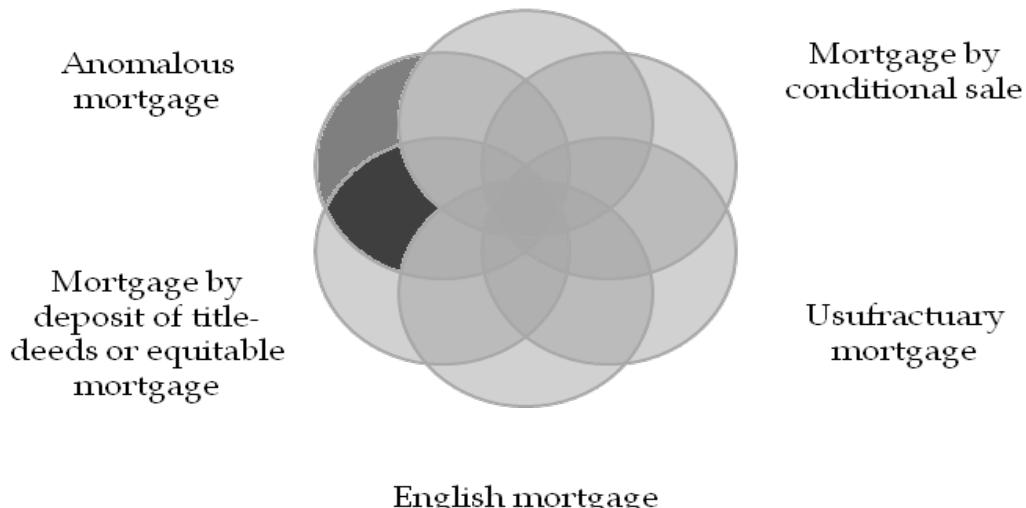
### *Form of a mortgage contract:*

According to Section 59, where the principal money secured is Rs. 100 or upwards, a mortgage, other than a mortgage by deposit of title-deeds, can be effected only by a registered instrument or by delivery of property. It should be noted that a mortgage is not a mere contract but it is the Conveyance of Interest in the mortgaged property and as soon as the mortgage deed is registered an interest in the property vests in the mortgagee.

### ***Kinds of mortgages:***

There are in all six kinds of mortgages in immoveable property, namely

#### **Simple mortgage**



#### **(a) Simple mortgage**

In a simple mortgage, the mortgagor binds himself personally to pay the debt and agrees in the event of his failure to pay the mortgage money, the mortgagee shall have the right to cause the property to be applied so far as may be necessary by means of a decree for the sale of property. If the mortgaged property is not sufficient to discharge the debt, the mortgagee can bring a personal action against the mortgagor and obtain a decree which, like any other money decree, can be executed against other properties of the mortgagor. In simple mortgage, no right of possession or foreclosure is available to the mortgagee.

#### **(b) Mortgage by conditional sale**

In this type of mortgage, the property is mortgaged with a condition super added that in the event of a failure by the debtor to repay the debt at the stipulated time, the transaction should be regarded a sale, and in case the loan is repaid at the stipulated time, the sale shall be invalid, or on condition that on such payment being made the buyer shall transfer the property to the seller.

Thus, for all practical purposes, this type of mortgage is ostensible sale of the mortgaged property with a condition for re-purchase by the mortgagor by repaying the loan.

It may be noted that the mortgagor transfers the property with the following three conditions:

- (a) If the loan is repaid, the sale becomes void.
- (b) If the loan is not repaid at the stipulated time, the sale will become absolute and binding.
- (c) When the debt has been repaid at the stipulated time, the mortgagee shall re-transfer the property to the mortgagor.

In case of mortgage by conditional sale, there is no personal covenant. That is unlike in the case of a simple mortgage, the mortgagor in this case does not bind himself personally to repay the debt. The mortgagee is not given the possession of the property in this type of mortgage. This is also the position in the case of a simple mortgage. Again, in a mortgage by conditional sale, the mortgagee's remedy is 'foreclosure', that is he becomes the owner of the property in default of payment of the debt by the mortgagor, he has to institute a regular suit in a Court of law to "foreclose" the mortgage. To "foreclose" means to debar the mortgagor from redeeming the property forever.

### (c) Usufructuary mortgage

Section 58(d) defines a "usufructuary mortgage" as "where the mortgagor delivers possession or expressly or by implication binds himself to deliver possession of the mortgaged property to the mortgagee, and authorises him to retain such possession until payment of the mortgage money, and to receive the rents and profits accruing from the property or any part of such rents and profits and to appropriate the same in lieu of interest, or in payment of the mortgage money, or partly in lieu of interest or partly in payment of the mortgage money, the transaction is called an usufructuary mortgage. It is also called a mortgage with possession.

Thus in this type of mortgage the mortgagor has to deliver possession of the property to the mortgagee. If the possession is not given, the mortgagee can sue for possession. The mere fact that possession has not been delivered will not alter the nature of the transaction. In *Pratap Bahadur vs. Gajadhar*, 24 All 521, it was agreed that the mortgagee will put the mortgagor in possession of a village on a certain date and to pay interest till possession was delivered. It was held that mortgage was an usufructuary mortgage. The mortgagee is authorised to retain possession and receive rents, etc., until he recovers the whole debt and the interest. The usufructuary mortgagee has to look only to the profits that arise out of the property for realising his debt; there is no personal liability on the part of the mortgagor. Similarly, the mortgagee has no right to foreclose the mortgage or to sue for sale.

A mortgage may be regarded as usufructuary even though the entire debt is not to be paid out of the profits of the property. Therefore, a usufructuary mortgage may be either (i) where the entire mortgage money is to be paid from the profit of the land; or (ii) where only part of the mortgage money is principal or interest amount is to be paid from the profit of the land.

If in a usufructuary mortgage a time is mentioned during which the mortgagee should recover the debt, etc., then after the time is over, the mortgagee should deliver back the property to the mortgagor. He cannot refuse to give back the property, if he has not been able to recover the debt and the interest, etc. A usufructuary mortgagee is supposed to remain in possession of the mortgaged property and manage the same as a person of ordinary prudence would manage subject to the conditions of mortgage agreement. Any loss due to failure on his part would be debited to his account (*Panchanan Sharma v. B.P. Jagnani*, SCALE 1995 (2) 641).

Thus, a usufructuary mortgage has the following characteristics:

1. Possession of property must be delivered to the mortgagee;
2. There is no personal liability on the part of the mortgagor to pay;
3. The mortgagee is entitled to rents and profits in lieu of interest or principal or both; and
4. The mortgagee however is not entitled to foreclose the mortgagee or to sue for sale.

### (d) English mortgage

Section 58(e) states that: "where the mortgagor binds himself to repay the mortgage money on a certain date, and transfers the mortgaged property absolutely to the mortgagee but subject to a proviso that he will retransfer it to the mortgagor upon payment of the money as agreed, the transaction is called an English mortgage".

Here the mortgagor transfers the ownership of the property as security and the mortgagee promises to re-transfer the ownership, if the money is paid within a definite time. There is also a personal covenant as the mortgagor promises to repay within a certain date. In this type of mortgage, there is proviso that if money is repaid the property would be reconveyed. The remedy of the mortgagee is sale of the property to recover the debt.

The essential features of an English mortgage are as under:

1. The mortgagor binds himself to repay the mortgage money on a certain day. In other words, there should be a personal undertaking to pay.
2. The mortgaged property is absolutely transferred to the mortgagee.
3. Such absolute transfer is subject to a proviso that the mortgagee will reconvey the property to the mortgagor upon payment by him of the mortgage money on the fixed day.

## Distinction between English mortgage and mortgage by conditional sale

An English mortgage looks like a mortgage by conditional sale but there are obvious differences between the two:

1. In English mortgage there is a personal liability undertaken by the mortgagor to pay the debt. In a mortgage by conditional sale there is no personal covenant (agreement for payment of the mortgage money and mortgagee has his remedy against the mortgaged property only);
2. In English mortgage the ownership in the mortgaged property is absolutely transferred to the creditor (i.e. mortgagee) which however, may be divested on repayment of the loan on the fixed day.

In a mortgage by conditional sale, the mortgagee gets only a qualified ownership which may, however, ripen into an absolute ownership in default of payment of the mortgage money.

### (e) Mortgage by deposit of title deeds

This type of mortgage is called equitable mortgage in English law. In this transaction, a person delivers to the creditor or his agent documents of title of his immoveable property with an intention to create a security, and obtains a loan. The requisites of such a mortgage are (i) a debt, (ii) deposit of title deeds, and (iii) an intention that the deeds shall be security for the debt.

In order that a valid mortgage on an immoveable property should be effected, it must be in writing and attested by two witnesses and the document must be registered. But in case of a mortgage by deposit of title deeds, it need not be registered and an oral agreement between the person and the creditor followed by the delivery of the documents of title to the property is enough. The creditor will have the possession of the documents and he will advance the money at the stipulated rate of interest. In case the mortgagor does not repay the loan, the creditor on the basis of having the title deeds in his possession can sue the debtor to recover the money. This type of mortgage has been recognized due to expediency. Many persons, specially the business people, may need money urgently and they cannot wait till a formal document is written, signed, attested and then registered. So they will simply approach the creditor and hand over the title deeds of their property and borrow money. This avoids delay and other formalities for effecting a valid mortgage.

There must be a clear intention on the part of the person who hands over the title deeds to effect a valid mortgage. In the absence of any intention, the mere holding in possession of the title deeds will not create a valid mortgage.

The term 'documents of title' or title deeds means such documents as will show *prima facie* or apparent title to the property of the person who is borrowing money. Accordingly, in one case it was held that tax receipt was not a document of title to the property on which the tax was paid. What is necessary to deposit is a document which gives him his right to the property and the creditor should insist on the production of this document before he gives money on a pledge of documents.

It should be noted that this type of mortgage can be created only in certain towns and not everywhere in India. The facility to create a valid mortgage is available in the following towns in India: Calcutta, Madras, Bombay, Adoni, Ajmer, Allahabad, Alwar, Bangalore, Bellary, Cochin, Coimbatore, Delhi, Jaipur, Jodhpur, Kanpur, Rajahmundry, Udaipur, Vellore, Ellora, Pali, Bhilwara, Bikaner, Kakinada, Narayanganj, Mysore, and Madurai. Though this type of mortgage is limited to specific cities it is at par with any other legal mortgage (*K.J. Nathan v. S.V. Maruthi Rao*, A.I.R. 1965 S.C. 443).

Title deeds should be delivered in these areas, the property of the person may be situated elsewhere. If the deposit of title deeds has taken place in any other town, it will not be a valid mortgage. Similarly, if the property is situated in *any one of the towns* mentioned above, but the deposit of title deeds is made in other towns or areas then again it will not be a valid mortgage.

### (f) Anomalous mortgage

Section 58(g) of the Transfer of Property Act provides that "a mortgage which is not a simple mortgage, a mortgage by conditional sale, usufructuary mortgage, an English mortgage, or a mortgage by deposit of title deeds within the meaning of this section is called an anomalous mortgage".

Thus, an anomalous mortgage is a combination of various other mortgages, for example, a usufructuary mortgage may be created and the mortgagee shall have the right of sale. You have already noticed that in a usufructuary mortgage only possession is given to the mortgagee and there is no right of sale. But in an anomalous mortgage the right of sale along with the possession of the property may be given. You have also seen that in the case of usufructuary mortgage, there is no personal liability on the part of a mortgagor but if the mortgagor assumes personal liability to pay the mortgage money, it will be an anomalous mortgage.

Again, a mortgagee may be given possession of the property for a fixed period with a condition that in case the debt is not discharged at the expiry of the period mentioned, the mortgage shall be regarded as a mortgage by conditional sale. In this case, the mortgage has got a right of "foreclosure" and after the expiry of the period if the debt is not paid, the mortgagee will become the owner of the property.

Two other terms in common use in connection with mortgage may be considered here. These terms are (i) Sub-mortgage; and (ii) Puisne mortgage.

*Sub-mortgage:*

Where the mortgagee transfers by mortgage his interest in the mortgaged property, or creates a mortgage of a mortgage the transaction is known as a sub-mortgage. For example, where A mortgages his house to B for Rs. 10,000 and B mortgage his mortgagee right to C for Rs. 8,000. B creates a sub-mortgage.

*Puisne mortgage:*

Where the mortgagor, having mortgaged his property, mortgages it to another person to secure another loan, the second mortgage is called a puisne mortgage. For example, where A mortgages his house worth Rs. one lakh to B for Rs.40,000 and mortgages the same house to C for a further sum of Rs.30,000, the mortgage to B is first mortgage and that to C the second or puisne mortgage. C is the puisne mortgagee, and can recover the debt subject to the right of B, the first mortgagee, to recover his debt of Rs.40,000 plus interest.

*Rights of mortgagor:*

By mortgaging the property the mortgagor does not cease to be its owner, he only transfers an interest in it. The law, therefore, grants him the following rights:

- (a) Right of redemption: The first and the most important right of the mortgagor is the right to redeem i.e., take back the mortgaged property by paying the mortgage money at any time after the stipulated date for repayment. Section 60 of the Act provides that any time after the principal amount has become due, the mortgagor has a right to redeem the property. Although the Act gives him the right to redeem "any time" after their debt has become due, it enjoins upon the mortgagor the obligation to exercise this right before the right is extinguished by the Act of parties or by a decree of Court, or (ii) before it is barred by the Limitation Act. According to the Law of Limitation the, mortgagor can redeem the property within 60 years after the money has become due. This right to redeem the property even after the time of payment has elapsed is called the Right of Equity or Redemption. But the mortgagor is not entitled to redeem before the mortgage money becomes due on the date fixed for repayment of the loan. His right to redeem arises only when mortgage money becomes due and not before.
- (b) Right against clog on equity of redemption: Right of redemption or equity of redemption is the essence of a mortgage, and any provision inserted in the mortgage deed to prevent, evade or hamper redemption is void. Any condition which prevents the mortgagor from redeeming the property is called a "clog" on the equity or right of redemption and is void. The rule of equity that once a mortgage always a mortgage prohibits a clog on the right of redemption. In other words, once a transaction is found to be a mortgage, the Court would not permit any condition in a mortgage deed which would prevent or impede redemption or repayment of the loan for which the security was given.
- (c) Right of partial redemption: A mortgage, as a rule, being one and indivisible for the debt and every part of it, the mortgagor cannot redeem piecemeal; he must redeem the whole property. But Section 61 of the Act gives a right of partial redemption stating that "a mortgagor who has executed two or more mortgages in favour of the same mortgagee shall, in the absence of a contract to the contrary, when the principal money of any two or more of the mortgages has become due, be entitled to redeem any one such mortgage separately or any two or more of such mortgages together."

*Implied contract by mortgagor:*

The parties are free to enter into any terms they like. Where, however, the contract does not contain all the terms, Section 65 provides for implied terms as follows:

In the absence of a contract to the contrary, the mortgagor shall be deemed to have contracted with the mortgagee that the:

- (a) mortgagor is entitled to transfer the interest (covenant for title);
- (b) mortgagor will assist the mortgagee to enjoy quiet possession;
- (c) mortgagor will pay public charges in respect of the mortgaged property;
- (d) mortgagor covenants as to payment of the rent due on lease where, the mortgaged property is leased;
- (e) mortgagor covenants as to payment of interest and principal on prior encumbrances, where the mortgage is a second or subsequent encumbrance on the property.

*Rights of mortgagee and his remedies:*

If the mortgagor does not pay the mortgage money, the mortgagee may proceed to recover (i) from the mortgaged property, or (ii) sue for recovery from the mortgagor personally. Thus the mortgagor has two remedies: one against the property and the other against the mortgagor personally.

## 7. Charges

*Meaning of charge:* "Charge" has been defined under Section 100 as follows: "Where immoveable property of one person is by the act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property".

As is evident from the above definition, a charge comes into existence either by the act of parties or by operation of law.

*Charge by act of parties:* When in a transaction for value, both the parties (debtor and creditor) intend that the property existing or future shall be made available as security for the payment of a debt and that the creditor shall have a present right to have it made available, there is a charge.

*Charge by Operation of Law:* Charges created by law are those which arise on account of some statutory provisions. They are not created by the voluntary action of parties but arise as a result of some legal obligation.

*Floating charge:* A charge may be floating as well as fixed. A fixed charge is a charge on specific property but a floating charge is an equitable charge on the assets for time being of a going concern. It is peculiar to companies which are able to borrow money without any interference with their assets so long as they are going concern. In other words, it is a charge on a class of the assets of the company, present as well as future. The assets of the company are constantly undergoing a change but the creditors will not normally interfere with the assets of the company unless there is breach of some condition. As Professor Gower says, the assets are liquid and the charge is floating. It is ambulatory and shifting in its nature hovering over and so to speak floating with the property which it is intended to effect. As it does not attach to any specific property, it remains document until it crystallises.

A floating charge has the following characteristics:

1. It is a charge on class of assets both present and future.
2. The class of assets charged is one which in the ordinary course of business would be changing from time to time.
3. It is contemplated by the charge that until some future step is taken by those who are interested in the charge the company may carry on its business in the ordinary way, i.e., it may use its assets charged in the ordinary course of its business. (Per Roman L.J. in *Reyork Shive Wool Combers Associated Limited*, (1903) 2 Ch. 284) A floating charge is created by debentures on the company's undertaking or its estate, property and effects. It is not necessary that the charge should be on all company's assets. Thus a mortgage of a cinema and of the chattels used in the cinema premises was held to be a floating charge as to the chattels (*National Provisional Bank of England Limited v. Charteb Electric Theatres Limited*, (1916) Ch. 132). Similarly, a floating charge was created by a mortgage of book and other debts which shall become due during the continuance of this security (*Reyork Shive Wool Combers Association*, Supra).

## Crystallisation of floating charge

A floating charge becomes fixed or crystallises in the following cases:

1. When the money becomes payable under a condition in the debenture and the debenture holder, (i.e., the creditor) takes some steps to enforce the security;
2. When the company ceases to carry on business; and
3. When the company is being wound-up.

## 8. Distinction between Mortgage and Charge

Although in a charge, the property is made a security for the payment of the loan, yet the transaction does not amount to mortgage. It is important, therefore to distinguish between a charge and mortgage.

- (a) A mortgage is transfer of an interest in the property made by the mortgagor as a security for the loan, while the charge is not the transfer of any interest in the property though it is security for the payment of an amount.
- (b) A charge may be created by act of parties or by operation of law. A mortgage can only be created by act of parties.
- (c) A mortgage deed must be registered and attested by two witnesses, while a charge need not be made in writing, and if reduced to writing, it need not be attested or registered.
- (d) In certain types of mortgage (viz., mortgage by conditional sale and anomalous mortgage) the mortgagor can foreclose the mortgaged property but in charge, the charge-holder cannot foreclose though he can get the property sold as in a simple mortgage.
- (e) From the very nature of it, a charge as a general rule, cannot be enforced against a transferee for consideration without notice. But in a mortgage, the transferee of mortgaged property from the mortgagor, can only acquire the remaining interest of the mortgagor, and is therefore, only bound by the mortgage.
- (f) In a charge created by act of parties the specification of the particular fund or property negatives a personal liability and the remedy of the charge-holder is against the property only. In a mortgage, there can be security as well as personal liability. In fact, the absence of a personal liability is the principal test that distinguishes a charge from a simple mortgage.

### LESSON ROUND-UP

- The law relating to transfer of property is governed by the Transfer of Property Act, 1882. 'Transfer of Property' means an act by which a living person conveys property, in present or future, to one or more other living persons, or to himself, and one or more other living persons. 'living person' includes a company or association or body of individuals, whether incorporated or not.
- Every person who is competent to contract and entitled to transferable property, or authorized to dispose of property is competent to transfer such property. Property can be transferred either orally or by writing. Moveable property can be transferred by delivery of possession or by registration. In the case of tangible immoveable property of the value of one hundred rupees and upwards, or in the case of a reversion or other intangible thing, transfer can be made only by a registered instrument. In the case of tangible immoveable property of a value less than one hundred rupees, such transfer may be made either by a registered instrument or by delivery of the property.
- When property is transferred, the transferee should not be restrained absolutely from alienating the property. One may give property to another subject to a condition, but the condition should not be one which absolutely prevents the transferee from alienating the property. A transfer may also be made subject to a contingency which may or may not occur. This is known as condition subsequent. Condition subsequent is one which destroys or divests the rights upon the happening or non-happening of an event.

- Section 35 of the Transfer of Property Act deals with what is called doctrine of election. Election may be defined as "the choosing between two rights where there is a clear intention that both were not intended to be enjoyed". The foundation of doctrine of election is that a person taking the benefit of an instrument must also bear the burden, and he must not take under and against the same instrument.
- Where, with the consent, express or implied, of the persons interested in immoveable property, a person is the ostensible owner of such property and transfers the same for consideration, the transfer shall not be voidable on the ground that the transferor was not authorized to make it, provided that the transferee, after taking reasonable care to ascertain that the transferor had power to make the transfer, has acted in good faith. This is called doctrine of Holding Out.
- Doctrine of Feeding the Grant by Estoppel means where, a person fraudulently or erroneously represents that he is authorized to transfer certain immoveable property and professes to transfer such property for consideration, such transfer shall, at the option of the transferee, operate on any interest which the transferor may acquire in such property at any time during which the contract of transfer subsists.
- Where a person transfers his property so that his creditors shall not have anything out of the property, the transfer is called a fraudulent transfer. A debtor in order to defeat or delay the rights of a creditor, may transfer his property to some person, who may be his relative or a friend. The law does not allow this.
- The Act does not allow accumulation of income from the land for an unlimited period without the income-being enjoyed by owner of the property. The law allows accumulation of income for a certain period only. The period for which such accumulation is valid is : (a) the life of the transferor, or (b) eighteen years from the date of transfer. Any direction to accumulate the income beyond the period mentioned above is void. However, this is subject to certain exceptions.
- Lis pendens means a pending suit, action, petition or the like. Section 52 of the T.P. Act incorporates the doctrine of Lis pendens. It states that during the pendency of a suit in a court of law, property which is subject to a litigation cannot be transferred.
- The Act expressly provides for special types of transfers such as sale, exchange, gift, mortgage and lease. In a sale, exchange and gift, there is a transfer of the ownership of property but mortgage is a transfer of an interest in specific immoveable property and lease is a transfer of the right to enjoy immoveable property.
- Actionable claims are claims, to unsecured debts. If a debt is secured by the mortgage of immoveable property it is not an actionable claim, because the section clearly excludes such a debt.
- Charge under the Act has been defined as "where immoveable property of one person is by the act of parties or operation of law made security for the payment of money to another, and the transaction does not amount to a mortgage, the latter person is said to have a charge on the property".
- As is evident from the above definition, a charge comes into existence either by the act of parties or by operation of law. A charge may be floating as well as fixed. A fixed charge is a charge on specific property but a floating charge is an equitable charge on the assets for time being of a going concern. It is peculiar to companies which are able to borrow money without any interference with their assets so long as they are going concerns.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

- Discuss the object of the Transfer of Property Act. Distinguish between immoveable and moveable property.
- What is the subject matter of transfer under the T.P. Act? Discuss properties which cannot be transferred.
- Define a mortgage. Discuss various types of mortgages.
- What is the rule against perpetuity?
- Write short notes on
 

|                                       |                                  |
|---------------------------------------|----------------------------------|
| (i) Puisne mortgage;                  | (ii) Charges under the T.P. Act; |
| (iii) Vested and contingent interest; | (iv) Actionable claims.          |

## Lesson 17

# Real Estate (Regulation and Development) Act, 2016

### ***Key Concepts One Should Know***

- Real Estate Regulatory Authority
- Carpet Area
- Common Areas
- Occupancy Certificate
- Real Estate Project
- Planning Area
- Sanctioned Plan

### ***Learning Objectives***

#### **To understand:**

- Real Estate Sector
- Registration of Real Estate Project
- Real Estate Agents
- Real Estate Regulatory Authority
- Real Estate Appellate Tribunal
- Specimen Agreement for Sale between the Promoter and the Allottee
- Due Diligence Reporting

### ***Regulatory Framework***

- Real Estate (Regulation and Development) Act, 2016

### ***Lesson Outline***

- Objects and Reasons
- Salient Features of the Act
- Registration of Real Estate Project
- Real Estate Agents
- Real Estate Regulatory Authority
- Central Advisory Council
- The Real Estate Appellate Tribunal
- Offences, Penalties and Adjudication
- Specimen Agreement for Sale between the Promoter and the Allottee; Due Diligence Reporting
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

Real estate sector plays a catalytic role in fulfilling the needs and demand for housing and infrastructure in the country and is an important pillar of the economy. While this sector has grown significantly in recent years, it has been largely unregulated, with absence of professionalism and standardisation and lack of adequate consumer protection. It has no sectoral regulator like there are for other specific sectors like insurance, telecom, stock markets etc. History is witness to the fact that whenever sectoral regulators like SEBI, IRDAI, TRAI etc have been formed, they have helped in deepening the market and made it more robust. Though the Consumer Protection Act, 1986 is available as a forum to the buyers in the real estate market, the recourse is only curative and is not adequate to address all the concerns of buyers and promoters in that sector. The lack of standardisation has been a constraint to the healthy and orderly growth of industry. Therefore, since more than a decade the need for regulating the sector was being emphasised in various forums.

In view of the above, Parliament enacted the Real Estate (Regulation and Development) Act, 2016 which aims at protecting the rights and interests of consumers and promotion of uniformity and standardization of business practices and transactions in the real estate sector. It attempts to balance the interests of consumers and promoters by imposing certain responsibilities on both. It seeks to establish symmetry of information between the promoter and purchaser, transparency of contractual conditions, set minimum standards of accountability and a fast-track dispute resolution mechanism.

This Act will be put in operation just like the Motor Vehicles Act passed by the Central Government, pursuant to which respective State Governments ("SG") and Union Territories ("UT") are required to notify their own Rules, which would be in the lines of the Central Act and accordingly administer their own State Rules. Accordingly, every SG and UT are required to promulgate their own Real Estate Rules which would be based on the lines of the central Real Estate (Regulation and Development) Act 2016, and establish a Real Estate Regulatory Authority ("RERA") pursuant to the Rules, which will administer the respective Real Estate Rules of the State or UT.

**The objects and reasons for which the Act has been framed are:**

-  **Ensure accountability towards allottees and protect their interest**
-  **Infuse transparency, ensure fair-play and reduce frauds & delays**
-  **Introduce professionalism and pan India standardization**
-  **Establish symmetry of information between the promoter and allottee**
-  **Imposing certain responsibilities on both promoter and allottees**
-  **Establish regulatory oversight mechanism to enforce contracts**
-  **Establish fast- track dispute resolution mechanism**
-  **Promote good governance in the sector which in turn would create investor confidence**

**Chronology of events leading to regulation of real estate sector including both residential and commercial segments**

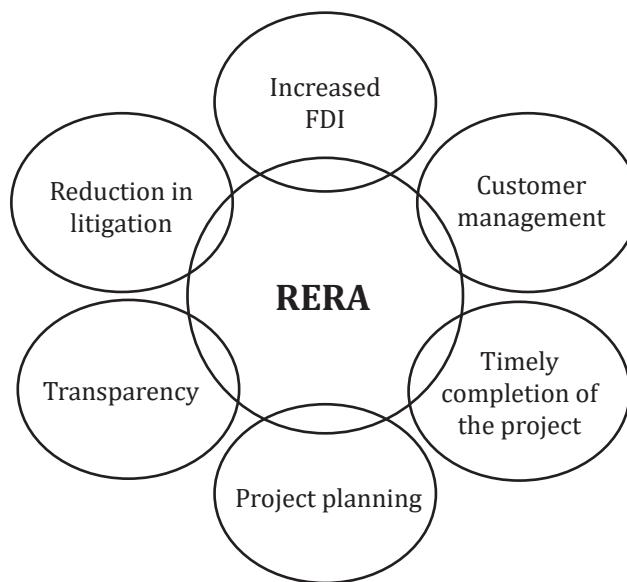
| S.No | Date             | Event  |
|------|------------------|--|
| 1.   | May, 2008        | Ministry of HUPA first prepared a Concept Paper on regulation of real estate sector and a model law for legislation by States/UTs  |
| 2.   | 2011             | Conference of Ministers of Housing suggested a central law for regulation of real estate sector  |
| 3.   | July, 2011       | Ministry of Law & Justice too suggested central legislation for regulation   |
| 4.   | June, 2013       | Union Cabinet approved Real Estate Bill, 2013  |
| 5.   | August, 2013     | Real Estate Bill was introduced in Rajya Sabha and was referred to Standing Committee  |
| 6.   | February, 2014   | Report of Standing Committee was laid on the Tables of both Houses of Parliament   |
| 7.   | February, 2014   | Attorney General upheld validity of central law for regulation of the Sector   |
| 8.   | April, 2015      | Union Cabinet approved official amendments based on recommendations of Standing Committee  |
| 9.   | May 20, 2015     | Matter referred to the Select Committee of Rajya Sabha   |
| 10.  | July, 2015       | Report of Select Committee tabled in Rajya Sabha   |
| 11.  | December, 2015   | incorporating several modifications based on Select Committee report and stakeholder consultations was approved by the Union Cabinet   |
| 12.  | 10 March, 2016   | The Real Estate (Regulation & Development) Bill, 2016 passed by Rajya Sabha  |
| 13.  | 15 March, 2016   | Lok Sabha passed the Bill as passed by Rajya Sabha   |
| 14.  | 25 March, 2016   | President gives assent to the Bill   |
| 15.  | 15 April, 2016   | 59 Sections of the Act were notified making them effective from May 1, 2016 enabling preparation of Real Estate Rules, setting up of Regulatory Authorities and other infrastructure |
| 16.  | 28 October, 2016 | Real Estate Removal of Difficulties Order  |
| 17.  | 19 April, 2017   | Remaining 32 Sections of the Act notified making them effective from May 1st this year requiring registration of projects within three months from tomorrow                          |
| 18.  | 1 May, 2017      | New era begins for development of real estate sector in an atmosphere of investor confidence   |

**SALIENT FEATURES OF THE ACT**

- Establish the Real Estate Regulatory Authority for regulation and promotion of the real estate sector
- Ensure sale of plot, apartment of building, as the case may be, or sale of real estate project, in an efficient and transparent manner
- Ensure protection the interest of consumers in the real estate sector
- Establish an adjudicating mechanism for speedy dispute redressal and also to establish the Appellate Tribunal to hear appeals from the decisions, directions or orders of the Real Estate Regulatory Authority (RERA)
- Regulates transactions between buyers and promoters of residential real estate projects
- Establishes state level regulatory authorities called Real Estate Regulatory Authorities (RERAs)
- Residential real estate projects, with some exceptions, need to be registered with RERAs

- Promoters cannot book or offer these projects for sale without registering them. Real estate agents dealing in these projects also need to register with RERAs
- Registration of the project, the promoter must upload details of the project on the website of the RERA.
- These include the site and layout plan, and schedule for completion of the real estate project
- Amount collected from buyers for a project must be maintained in a separate bank account and must only be used for construction of that project.
- Right to Legal Representation on behalf of client by Company Secretaries or chartered accountants or cost accountants or legal practitioners
- Imposes stringent penalty on promoter, real estate agent and also prescribes imprisonment.

### ADVANTAGES OF RERA (REAL ESTATE DEVELOPMENT AND REGULATION ACT)



RERA has brought in uniformity in definitions for important components of real estate, like, "carpet area", "common areas" etc. which will prevent malpractices like changes in area, specifications etc. Some of the important definitions are reproduced below:

### IMPORTANT DEFINITIONS

**"Advertisement"** means any document described or issued as advertisement through any medium and includes any notice, circular or other documents or publicity in any form, informing persons about a real estate project, or offering for sale of a plot, building or apartment or inviting persons to purchase in any manner such as plot, building or apartment or to make advances or deposits for such purposes;

**"Agreement for sale"** means an agreement entered into between the promoter and the allottee;

**"Allottee"** in relation to a real estate project, means the person to whom a plot, apartment or building, as the case may be, has been allotted, sold (whether as freehold or leasehold) or otherwise transferred by the promoter, and includes the person who subsequently acquires the said allotment through sale, transfer or otherwise but does not include a person to whom such plot, apartment or building, as the case may be, is given on rent;

**"Apartment"** whether called block, chamber, dwelling unit, flat, office, showroom, shop, godown, premises, suit, tenement, unit or by any other name, means a separate and self-contained part of any immovable property, including one or more rooms or enclosed spaces, located on one or more floors or any part thereof, in a building or on a plot of land, used or intended to be used for any residential or commercial use such as residence, office, shop, showroom or godown or for carrying on any business, occupation, profession or trade, or for any other type of use ancillary to the purpose specified;

**“Building”** includes any structure or erection or part of a structure or erection which is intended to be used for residential, commercial or for the purpose of any business, occupation, profession or trade, or for any other related purposes;

**“Carpet area”** means the net usable floor area of an apartment, excluding the area covered by the external walls, areas under services shafts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by the internal partition walls of the apartment.

*Explanation* – the expression “exclusive balcony or verandah area” means the area of the balcony or verandah, as the case may be, which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee; and “exclusive open terrace area” means the area of open terrace which is appurtenant to the net usable floor area of an apartment, meant for the exclusive use of the allottee;

**“Commencement certificate”** means the commencement certificate or the building permit or the construction permit, by whatever name called issued by the competent authority to allow or permit the promoter to begin development works on an immovable property, as per the sanctioned plan;

**“Common areas”** mean–

- (i) the entire land for the real estate project or where the project is developed in phases and registration under this Act is sought for a phase, the entire land for that phase;
- (ii) the stair cases, lifts, staircase and lift lobbies, fire escapes, and common entrances and exits of buildings;
- (iii) the common basements, terraces, parks, play areas, open parking areas and common storage spaces;
- (iv) the premises for the lodging of persons employed for the management of the property including accommodation for watch and ward staffs or for the lodging of community service personnel;
- (v) installations of central services such as electricity, gas, water and sanitation, air-conditioning and incinerating, system for water conservation and renewable energy;
- (vi) the water tanks, sumps, motors, fans, compressors, ducts and all apparatus connected with installations for common use;
- (vii) all community and commercial facilities as provided in the real estate project;
- (viii) all other portion of the project necessary or convenient for its maintenance, safety, etc., and in common use;

**“Company”** means a company incorporated and registered under the Companies Act, 2013 and includes,–

- (i) a corporation established by or under any Central Act or State Act;
- (ii) a development authority or any public authority established by the Government in this behalf under any law for the time being in force;

**“Competent authority”** means the local authority or any authority created or established under any law for the time being in force by the appropriate Government which exercises authority over land under its jurisdiction, and has powers to give permission for development of such immovable property;

**“Completion certificate”** means the completion certificate, or such other certificate, by whatever name called, issued by the competent authority certifying that the real estate project has been developed according to the sanctioned plan, layout plan and specifications, as approved by the competent authority under the local laws;

**“Day”** means the working day, in the concerned State or Union territory, as the case may be, notified by the appropriate Government from time to time;

**“Development”** with its grammatical variations and cognate expressions, means carrying out the development of immovable property, engineering or other operations in, on, over or under the land or the making of any material change in any immovable property or land and includes re-development;

**“Development works”** means the external development works and internal development works on immovable property;

**"Estimated cost of real estate project"** means the total cost involved in developing the real estate project and includes the land cost, taxes, cess, development and other charges;

**"External development works"** includes roads and road systems landscaping, water supply, sewage and drainage systems, electricity supply transformer, sub-station, solid waste management and disposal or any other work which may have to be executed in the periphery of, or outside, a project for its benefit, as may be provided under the local laws;

**"Family"** includes husband, wife, minor son and unmarried daughter wholly dependent on a person;

**"Garage"** means a place within a project having a roof and walls on three sides for parking any vehicle, but does not include an unenclosed or uncovered parking space such as open parking areas;

**"Immovable property"** includes land, buildings, rights of ways, lights or any other benefit arising out of land and things attached to the earth or permanently fastened to anything which is attached to the earth, but not standing timber, standing crops or grass;

**"Interest"** means the rates of interest payable by the promoter or the allottee, as the case may be.

*Explanation.-*

- (i) the rate of interest chargeable from the allottee by the promoter, in case of default, shall be equal to the rate of interest which the promoter shall be liable to pay the allottee, in case of default;
- (ii) the interest payable by the promoter to the allottee shall be from the date the promoter received the amount or any part thereof till the date the amount or part thereof and interest thereon is refunded, and the interest payable by the allottee to the promoter shall be from the date the allottee defaults in payment to the promoter till the date it is paid;

**"Internal development works"** means roads, footpaths, water supply, sewers, drains, parks, tree planting, street lighting, provision for community buildings and for treatment and disposal of sewage and sullage water, solid waste management and disposal, water conservation, energy management, fire protection and fire safety requirements, social infrastructure such as educational health and other public amenities or any other work in a project for its benefit, as per sanctioned plans;

**"Local authority"** means the Municipal Corporation or Municipality or Panchayats or any other Local Body constituted under any law for the time being in force for providing municipal services or basic services, as the case may be, in respect of areas under its jurisdiction;

**"Occupancy certificate"** means the occupancy certificate, or such other certificate by whatever name called, issued by the competent authority permitting occupation of any building, as provided under local laws, which has provision for civic infrastructure such as water, sanitation and electricity;

**"Person"** includes,-

- (i) an individual;
- (ii) a Hindu undivided family;
- (iii) a company;
- (iv) a firm under the Indian Partnership Act, 1932 or the Limited Liability Partnership Act, 2008, as the case may be;
- (v) a competent authority;
- (vi) an association of persons or a body of individuals whether incorporated or not;
- (vii) a co-operative society registered under any law relating to co-operative societies;
- (viii) any such other entity as the appropriate Government may, by notification, specify in this behalf;

**"Planning area"** means a planning area or a development area or a local planning area or a regional development plan area, by whatever name called, or any other area specified as such by the appropriate Government or any competent authority and includes any area designated by the appropriate Government or the competent authority to be a planning area for future planned development, under the law relating to Town and Country Planning for the time being in force and as revised from time to time;

**"Promoter"** means,-

- (i) a person who constructs or causes to be constructed an independent building or a building consisting of apartments, or converts an existing building or a part thereof into apartments, for the purpose of selling all or some of the apartments to other persons and includes his assignees; or
- (ii) a person who develops land into a project, whether or not the person also constructs structures on any of the plots, for the purpose of selling to other persons all or some of the plots in the said project, whether with or without structures thereon; or
- (iii) any development authority or any other public body in respect of allottees of-
  - (a) buildings or apartments, as the case may be, constructed by such authority or body on lands owned by them or placed at their disposal by the Government; or
  - (b) plots owned by such authority or body or placed at their disposal by the Government, for the purpose of selling all or some of the apartments or plots; or
- (iv) an apex State level co-operative housing finance society and a primary co-operative housing society which constructs apartments or buildings for its members or in respect of the allottees of such apartments or buildings; or
- (v) any other person who acts himself as a builder, coloniser, contractor, developer, estate developer or by any other name or claims to be acting as the holder of a power of attorney from the owner of the land on which the building or apartment is constructed or plot is developed for sale; or
- (vi) such other person who constructs any building or apartment for sale to the general public.

Explanation.- where the person who constructs or converts a building into apartments or develops a plot for sale and the persons who sells apartments or plots are different persons, both of them shall be deemed to be the promoters and shall be jointly liable as such for the functions and responsibilities specified, under this Act or the rules and regulations made there under;

**"Prospectus"** means any document described or issued as a prospectus or any notice, circular, or other document offering for sale or any real estate project or inviting any person to make advances or deposits for such purposes;

**"Real estate agent"** means any person, who negotiates or acts on behalf of one person in a transaction of transfer of his plot, apartment or building, as the case may be, in a real estate project, by way of sale, with another person or transfer of plot, apartment or building, as the case may be, of any other person to him and receives remuneration or fees or any other charges for his services whether as commission or otherwise and includes a person who introduces, through any medium, prospective buyers and sellers to each other for negotiation for sale or purchase of plot, apartment or building, as the case may be, and includes property dealers, brokers, middlemen by whatever name called;

**"Real estate project"** means the development of a building or a building consisting of apartments, or converting an existing building or a part thereof into apartments, or the development of land into plots or apartment, as the case may be, for the purpose of selling all or some of the said apartments or plots or building, as the case may be, and includes the common areas, the development works, all improvements and structures thereon, and all easement, rights and appurtenances belonging thereto;

**"Sanctioned plan"** means the site plan, building plan, service plan, parking and circulation plan, landscape plan, layout plan, zoning plan and such other plan and includes structural designs, if applicable, permissions such as environment permission and such other permissions, which are approved by the competent authority prior to start of a real estate project;

***Appropriate Government'***

Section 2(g) of the Act defines 'appropriate Government' to mean as follows:

- (i) for the Union territory without Legislature, the Central Government;
- (ii) for the Union territory of Puducherry, the Union territory Government;
- (iii) for the Union territory of Delhi, the Central Ministry of Urban Development;
- (iv) for the State, the State Government.

### Responsibilities of the Appropriate Government

- (a) As per section 84 of the Act the appropriate Government is required to notify Rules for the implementation of the Act.
- (b) As per section 20 of the Act the appropriate Government is required to establish the Regulatory Authority.
- (c) As per section 20 of the Act the appropriate Government is required to appoint Regulatory Authority.
- (d) As per section 43 of the Act the appropriate Government is required to establish the Appellate Tribunal.
- (e) The Chairperson and Members of the Regulatory Authority and the Members of the Appellate Tribunal are required to be appointed based on recommendations of a Selection Committee, thus the appropriate Government is required to constitute the Selection Committee.
- (f) As per section 28 and section 51 the appropriate Government is required to appoint officers and other employees of Regulatory Authority and the Appellate Tribunal.
- (g) As per section 41 the Central Government (i.e. the Ministry of HUPA) is required to establish the Central Advisory Council.
- (h) As per section 75 the appropriate Government is required to constitute a 'Real Estate Regulatory Fund'.

## REGISTRATION OF REAL ESTATE PROJECT AND REGISTRATION OF REAL ESTATE AGENTS

Many developers across India follow a common practice of pre-launching a project without securing requisite approvals for the project from the local authorities, which is termed as "soft launch", "pre-launch" etc. Buyers also lap into this opportunity as they get discounted prices during the pre-launches period. But if it is from a developer who is unscrupulous or a fly by night operator, then it carries a great risk. Hence, to plug this gap, registration of every project with the regulatory authority has been mandatory before it is launched for sale and for registration the basic pre-requisite is that the developer must have all the requisite approvals. Thus the buyer is protected as the project is ring-fenced from the vagaries of non-approvals or delays in approvals which are one of the major causes of delay for the project.

### Prior Registration of Real Estate project with Real Estate Regulatory Authority

A promoter shall not advertise, market, book, sell or offer for sale, or invite persons to purchase in any manner any plot, apartment or building, as the case may be, in any real estate project or part of it, in any planning area, without registering the real estate project with the Real Estate Regulatory Authority established.

The projects that are ongoing on the date of commencement of this Act and for which the completion certificate has not been issued, the promoter shall make an application to the Authority for registration of the said project within a period of three months from the date of commencement of this Act.

Authority in the interest of allottees, for projects which are developed beyond the planning area but with the requisite permission of the local authority, it may, by order, direct the promoter of such project to register with the Authority, and the provisions of this Act or the rules and regulations made there under, shall apply to such projects from that stage of registration where the real estate project is to be developed in phases, every such phase shall be considered a stand alone real estate project, and the promoter shall obtain registration under this Act for each phase separately.

### Projects exempt from the ambit of the Act

The following projects do not require to be registered under the Act:

1. Area of land does not exceed 500 Sq. Meters
2. No. of apartments does not exceed 8

In case of Renovation/ Repair/Re-development

- (a) where the area of land proposed to be developed does not exceed five hundred square meters or the number of apartments proposed to be developed does not exceed eight, inclusive of all phases;
- (b) where the promoter has received completion certificate for a real estate project prior to commencement of this Act;

for the purpose of renovation or repair or re-development which does not involve marketing, advertising selling or new allotment of any apartment, plot or building, as the case may be, under the real estate project.

### Application for Registration of real estate projects

Every promoter shall make an application to the Authority for registration of the real estate project in such form, manner, within such time and accompanied by such fee as may be specified by the regulations made by the Authority.

| Step 1  | Step 2   | Step 3   |
|---|--|--|
| Applicant has to file an application for registration with RERA in prescribed form along with prescribed fees and documents | Application for registration must be either approved or rejected within a period of 30 days from the date of application by the RERA | On successful registration, the promoter of the project will be provided with a registration number, a login id and password for the applicant |

The promoter shall enclose the following documents along with the application, namely:-

- (a) a brief details of his enterprise including its name, registered address, type of enterprise (proprietorship, societies, partnership, companies, competent authority), and the particulars of registration, and the names and photographs of the promoter;
- (b) a brief detail of the projects launched by him, in the past five years, whether already completed or being developed, as the case may be, including the current status of the said projects, any delay in its completion, details of cases pending, details of type of land and payments pending;
- (c) an authenticated copy of the approvals and commencement certificate from the competent authority obtained in accordance with the laws as may be applicable for the real estate project mentioned in the application, and where the project is proposed to be developed in phases, an authenticated copy of the approvals and commencement certificate from the competent authority for each of such phases;
- (d) the sanctioned plan, layout plan and specifications of the proposed project or the phase thereof, and the whole project as sanctioned by the competent authority;
- (e) the plan of development works to be executed in the proposed project and the proposed facilities to be provided thereof including fire fighting facilities, drinking water facilities, emergency evacuation services, use of renewable energy;
- (f) the location details of the project, with clear demarcation of land dedicated for the project along with its boundaries including the latitude and longitude of the end points of the project;
- (g) proforma of the allotment letter, agreement for sale, and the conveyance deed proposed to be signed with the allottees;
- (h) the number, type and the carpet area of apartments for sale in the project along with the area of the exclusive balcony or verandah areas and the exclusive open terrace areas apart from the apartment, if any;
- (i) the number and areas of garage for sale in the project;
- (j) the names and addresses of his real estate agents, if any, for the proposed project;
- (k) the names and addresses of the contractors, architect, structural engineer, if any and other persons concerned with the development of the proposed project;
- (l) a declaration, supported by an affidavit, which shall be signed by the promoter or any person authorised by the promoter, stating:-
  - (A) that he has a legal title to the land on which the development is proposed along with legally valid documents with authentication of such title, if such land is owned by another person;

(B) that the land is free from all encumbrances, or as the case may be details of the encumbrances on such land including any rights, title, interest or name of any party in or over such land along with details;

(C) the time period within which he undertakes to complete the project or phase thereof, as the case may be;

that seventy per cent. of the amounts realised for the real estate project from the allottees, from time to time, shall be deposited in a separate account to be maintained in a scheduled bank to cover the cost of construction and the land cost and shall be used only for that purpose:

The promoter shall withdraw the amounts from the separate account, to cover the cost of the project, in proportion to the percentage of completion of the project. The amounts from the separate account shall be withdrawn by the promoter after it is certified by an engineer, an architect and a chartered accountant in practice that the withdrawal is in proportion to the percentage of completion of the project.

The promoter shall get his accounts audited within six months after the end of every financial year by a chartered accountant in practice, and shall produce a statement of accounts duly certified and signed by such chartered accountant and it shall be verified during the audit that the amounts collected for a particular project have been utilised for the project and the withdrawal has been in compliance with the proportion to the percentage of completion of the project.

The promoter shall take all the pending approvals on time, from the competent authorities and furnished such other documents as may be prescribed by the rules or regulations made under.

The Authority shall operationalise a web based online system for submitting applications for registration of projects within a period of one year from the date of its establishment.

### Granting of Registration by the Authority

On receipt of the application, the Authority shall within a period of thirty days-

- (a) grant registration subject to the provisions of the Act and the rules and regulations made thereunder. A registration number, including a Login Id and password to the applicant for accessing the website of the Authority and to create his web page and to fill therein the details of the proposed project; or
- (b) reject the application for reasons to be recorded in writing, if such application does not conform to the provisions of this Act or the rules or regulations made thereunder. Application shall not be rejected unless the applicant has been given an opportunity of being heard in the matter.

If the Authority fails to grant the registration or reject the application, as the case may be, the project shall be deemed to have been registered, and the Authority shall within a period of seven days of the expiry of the said period of thirty days specified.

The registration granted shall be valid for a period declared by the promoter for completion of the project or phase thereof, as the case may be.

### Extension of registration

Delay in handing over of projects by the developer within the stipulated time frame has been a major woe of the buyers and hence has been a major trigger for promulgation of this Act. Hence, at the time of registration, a developer has to specify a time line during which he will complete and handover the project to the buyer. The timeline is very sacrosanct because if he fails to do so within the stated time, then there are rigorous provisions in the Act as prescribed in section 7 & 8 whereby his registration would be revoked and his project would be usurped by the Regulator. Though as per section 6, an extension of registration may be granted at the sole discretion of the regulator due to Force Majeure conditions or if there are reasonable circumstances which merit extension.

The registration granted may be extended by the Authority on an application made by the promoter due to force majeure, in such form and on payment of such fee as may be specified by regulations made by the Authority.

**“Force majeure”** shall mean a case of war, flood, drought, fire, cyclone, earthquake or any other calamity caused by nature affecting the regular development of the real estate project.

The Authority may in reasonable circumstances, without default on the part of the promoter, based on the facts of each case, and for reasons to be recorded in writing, extend the registration granted to a project for such time as it considers necessary, which shall, in aggregate, not exceed a period of one year.

Application for extension of registration shall not be rejected unless the applicant has been given an opportunity of being heard in the matter.

### Revocation of registration

The Authority may, on receipt of a complaint or suomoto in this behalf or on the recommendation of the competent authority, revoke the registration granted, after being satisfied that-

- the promoter makes default in doing anything required by or under this Act or the rules or the regulations made there under;
- the promoter violates any of the terms or conditions of the approval given by the competent authority;
- the promoter is involved in any kind of unfair practice or irregularities.

The term "unfair practice means" a practice which, for the purpose of promoting the sale or development of any real estate project adopts any unfair method or unfair or deceptive practice including any of the following practices, namely:-

- the practice of making any statement, whether in writing or by visible representation which,-
  - falsely represents that the services are of a particular standard or grade;
  - represents that the promoter has approval or affiliation which such promoter does not have;
  - makes a false or misleading representation concerning the services;
- the promoter permits the publication of any advertisement or prospectus whether in any newspaper or otherwise of services that are not intended to be offered;
  - the promoter indulges in any fraudulent practices.

The registration granted to the promoter shall not be revoked unless the Authority has given to the promoter not less than thirty days' notice, in writing, stating the grounds on which it is proposed to revoke the registration, and has considered any cause shown by the promoter within the period of that notice against the proposed revocation.

The Authority may, instead of revoking the registration, permit it to remain in force subject to such further terms and conditions as it thinks fit to impose in the interest of the allottees, and any such terms and conditions so imposed shall be binding upon the promoter.

The Authority, upon the revocation of the registration-

- Debar the promoter from accessing its website in relation to that project and specify his name in the list of defaulters and display his photograph on its website and also inform the other Real Estate Regulatory Authority in other States and Union territories about such revocation or registration;
- Facilitate the remaining development works to be carried out in accordance with the provisions of section 8;
- Direct the bank holding the project back account to freeze the account, and thereafter take such further necessary actions, including consequent de-freezing of the said account, towards facilitating the remaining development works in accordance with the provisions of section 8;
- To protect the interest of allottees or in the public interest, issue such directions as it may deem necessary.

### Obligation of Authority consequent upon lapse of or on revocation of registration (Section 8)

Upon lapse of the registration or on revocation of the registration under the Act, the authority, may consult the appropriate Government to take such action as it may deem fit including the carrying out of the remaining development works by competent authority or by the association of allottees or in any other manner, as may be determined by the Authority.

The direction, decision or order of the Authority shall not take effect until the expiry of the period of appeal provided under the provisions of the Act:

In case of revocation of registration of a project under the Act, the association of allottees shall have the first right of refusal for carrying out of the remaining development works.

### Registration of real estate agents

Real estate broking is one of the easiest business in India as there are no specific qualification or experience requirements and also there is no code of practice which sets accountability, transparency and professional benchmarks. Hence, there are thousands of non-professional agents/ brokers in every city operating without any accountability. Hence, to bring in transparency and accountability, agents have also been covered under the ambit of RERA and registration requirement has been mandatory for them as per section 9 of the Act.

Without obtaining registration, real estate agent shall not facilitate the sale or purchase of or act on behalf of any person to facilitate the sale or purchase of any plot, apartment or building, as the case may be, in a real estate project or part of it, being the part of the real estate project registered, being sold by the promoter in any planning area.

Every real estate agent shall make an application to the Authority for registration in such form, manner, within such time and accompanied by such fee and documents as may be prescribed.

The Authority shall, within such period, in such manner and upon satisfying itself of the fulfilment of such conditions, as may be prescribed—

- (a) grant a single registration to the real estate agent for the entire State of Union territory, as the case may be;
- (b) reject the application for reasons to be recorded in writing, if such application does not conform to the provisions of the Act or the rules or regulations made there under:

Application shall not be rejected unless the applicant has been given an opportunity of being heard in the matter.

Whereon the completion of the period prescribed under the act, if the applicant does not receive any communication about the deficiencies in his application or the rejection of his application, he shall be deemed to have been registered.

Every real estate agent who is registered as per the provisions of this Act or the rules and regulations made there under, shall be granted a registration number by the Authority, which shall be quoted by the real estate agent in every sale facilitated by him under this Act.

Every registration shall be valid for such period as may be prescribed, and shall be renewable for a period in such manner and on payment of such fee as may be prescribed.

Where any real estate agent who has been granted registration under this Act commits breach of any of the conditions thereof or any other terms and conditions specified under this Act or any rules or regulations made there under, or where the Authority is satisfied that such registration has been secured by the real estate agent through misrepresentation or fraud, the Authority may, without prejudice to any other provisions under this Act, revoke the registration or suspend the same for such period as it thinks fit:

Provided that no such revocation or suspension shall be made by the Authority unless an opportunity of being heard has been given to the real estate agent.

### Functions of real estate agents

Every real estate agent which is not registered with the Authority shall not facilitate the sale or purchase of any plot, apartment or building, as the case may be, in a real estate project or part of it, being sold by the promoter in any planning area. So, firstly they require to register themselves with the authority.

Every real estate agent maintains and preserves such books of account, records and documents as may be prescribed.

Every real estate agent not to involve himself in any unfair trade practices, namely:—

- (i) the practice of making any statement, whether orally or in writing or by visible representation which—
  - falsely represents that the services are of a particular standard or grade;

- represents that the promoter or himself has approval or affiliation which such promoter or himself does not have;
- makes a false or misleading representation concerning the services;
- (ii) permitting the publication of any advertisement whether in any newspaper or otherwise of services that are not intended to be offered.

Every real estate agent shall facilitate the possession of all the information and documents, as the allottee, is entitled to, at the time of booking of any plot, apartment or building, as the case may be and discharge such other functions as may be prescribed.

## FUNCTIONS AND DUTIES OF PROMOTER

The most important duty of the promoter which has been mandated by the Act is to provide complete details of the project so that a layman who does not even know the legal requirements is able to check the legal sanctity of the project. The promoter has also been debarred from advertising and selling his project until he has procured the requisite approvals from the authorities and got his project registered with RERA.

### Functions and duties of promoter

The promoter shall, upon receiving his Login Id and password, as the case may be, create his web page on the website of the Authority and enter all details of the proposed project for public viewing, including-

- (a) details of the registration granted by the Authority;
- (b) quarterly up-to-date the list of number and types of apartments or plots, as the case may be, booked;
- (c) quarterly up-to-date the list of number of garages booked;
- (d) quarterly up-to-date the list of approvals taken and the approvals which are pending subsequent to commencement certificate;
- (e) quarterly up-to-date status of the project; and
- (f) such other information and documents as may be specified by the regulations made by the Authority.

The advertisement or prospectus issued or published by the promoter shall mention prominently the website address of the Authority, wherein all details of the registered project have been entered and include the registration number obtained from the Authority and such other matters incidental thereto.

The promoter at the time of the booking and issue of allotment letter shall be responsible to make available to the allottee, the following information, namely:-

- A. sanctioned plans, layout plans, along with specifications, approved by the competent authority, by display at the site or such other place as may be specified by the regulations made by the Authority;
- B. the stage wise time schedule of completion of the project, including the provisions for civic infrastructure like water, sanitation and electricity.

The promoter shall-

- (a) be responsible for all obligations, responsibilities and functions under the provisions of the Act or the rules and regulations made thereunder or to the allottees as per the agreement for sale, or to the association of allottees, as the case may be, till the conveyance of all the apartments, plots or buildings, as the case may be, to the allottees, or the common areas to the association of allottees or the competent authority, as the case may be:

Provided that the responsibility of the promoter, with respect to the structural defect or any other defect for such period as is referred to in sub-section (3) of section 14, shall continue even after the conveyance deed of all the apartments, plots or buildings, as the case may be, to the allottees are executed.

- (b) be responsible to obtain the completion certifi or the occupancy certifi or both, as applicable, from the relevant competent authority as per local laws or other laws for the time being in force and to make it available to the allottees individually or to the association of allottees, as the case may be;

- (c) be responsible to obtain the lease certificate, where the real estate project is developed on a leasehold land, specifying the period of lease, and certifying that all dues and charges in regard to the leasehold land has been paid, and to make the lease certificate available to the association of allottees;
- (d) be responsible for providing and maintaining the essential services, on reasonable charges, till the taking over of the maintenance of the project by the association of the allottees;
- (e) enable the formation of an association or society or co-operative society, as the case may be, of the allottees, or a federation of the same, under the laws applicable:  
Provided that in the absence of local laws, the association of allottees, by whatever name called, shall be formed within a period of three months of the majority of allottees having booked their plot or apartment or building, as the case may be, in the project;
- (f) execute a registered conveyance deed of the apartment, plot or building, as the case may be, in favour of the allottee along with the undivided proportionate title in the common areas to the association of allottees or competent authority, as the case may be, as provided under section 17 of this Act;
- (g) pay all outgoings until he transfers the physical possession of the real estate project to the allottee or the associations of allottees, as the case may be, which he has collected from the allottees, for the payment of outgoings (including land cost, ground rent, municipal or other local taxes, charges for water or electricity, maintenance charges, including mortgage loan and interest on mortgages or other encumbrances and such other liabilities payable to competent authorities, banks and financial institutions, which are related to the project):  
Provided that where any promoter fails to pay all or any of the outgoings collected by him from the allottees or any liability, mortgage loan and interest thereon before transferring the real estate project to such allottees, or the association of the allottees, as the case may be, the promoter shall continue to be liable, even after the transfer of the property, to pay such outgoings and penal charges, if any, to the authority or person to whom they are payable and be liable for the cost of any legal proceedings which may be taken therefore by such authority or person;
- (h) after he executes an agreement for sale for any apartment, plot or building, as the case may be, not mortgage or create a charge on such apartment, plot or building, as the case may be, and if any such mortgage or charge is made or created then notwithstanding anything contained in any other law for the time being in force, it shall not affect the right and interest of the allottee who has taken or agreed to take such apartment, plot or building, as the case may be;

The promoter may cancel the allotment only in terms of the agreement for sale. However the allottee may approach the Authority for relief, if he is aggrieved by such cancellation and such cancellation is not in accordance with the terms of the agreement for sale, unilateral and without any sufficient cause.

The promoter shall prepare and maintain all such other details as may be specified, from time to time, by regulations made by the Authority.

### **Obligations of promoter regarding veracity of the advertisement or prospectus**

Where any person makes an advance or a deposit on the basis of the information contained in the notice advertisement or prospectus, or on the basis of any model apartment, plot or building, as the case may be, and sustains any loss or damage by reason of any incorrect, false statement included therein, he shall be compensated by the promoter in the manner as provided under the Act.

If the person affected by such incorrect, false statement contained in the notice, advertisement or prospectus, or the model apartment, plot or building, as the case may be, intends to withdraw from the proposed project, he shall be returned his entire investment along with interest at such rate as may be prescribed and the compensation in the manner provided under the Act.

### **No deposit or advance to be taken by promoter without first entering into agreement for sale**

A promoter shall not accept a sum more than ten per cent of the cost of the apartment, plot, or building as the case may be, as an advance payment or an application fee, from a person without first entering into a written agreement for sale with such person and register the said agreement for sale, under any law for the time being in force.

The agreement for sale shall be in such form as may be prescribed and shall specify the particulars of development of the project including the construction of building and apartments, along with specifications and internal development works and external development works, the dates and the manner by which payments towards the cost of the apartment, plot or building, as the case may be, are to be made by the allottees and the date on which the possession of the apartment, plot or building is to be handed over, the rates of interest payable by the promoter to the allottee and the allottee to the promoter in case of default, and such other particulars, as may be prescribed.

### **Adherence to sanctioned plans and project specifications by the promoter**

The proposed project shall be developed and completed by the promoter in accordance with the sanctioned plans, layout plans and specifications as approved by the competent authorities.

Notwithstanding anything contained in any law, contract or agreement, after the sanctioned plans, layout plans and specifications and the nature of the fixtures, fittings, amenities and common areas, of the apartment, plot or building, as the case may be, as approved by the competent authority, are disclosed or furnished to the person who agree to take one or more of the said apartment, plot or building, as the case may be, the promoter shall not make—

- (i) any additions and alterations in the sanctioned plans, layout plans and specifications and the nature of fixtures, fittings and amenities described therein in respect of the apartment, plot or building, as the case may be, which are agreed to be taken, without the previous consent of that person:

The promoter may make such minor additions or alterations as may be required by the allottee, or such minor changes or alterations as may be necessary due to architectural and structural reasons duly recommended and verified by an authorised Architect or Engineer after proper declaration and intimation to the allottee.

“minor additions or alterations” excludes structural change including an addition to the area or change in height, or the removal of part of a building, or any change to the structure, such as the construction or removal or cutting into of any wall or a part of a wall, partition, column, beam, joist, floor including a mezzanine floor or other support, or a change to or closing of any required means of access ingress or egress or a change to the fixtures or equipment, etc.

- (ii) any other alterations or additions in the sanctioned plans, layout plans and specifications of the buildings or the common areas within the project without the previous written consent of at least two-thirds of the allottees, other than the promoter, who have agreed to take apartments in such building.

It may be noted that the allottees, irrespective of the number of apartments or plots, as the case may be, booked by him or booked in the name of his family, or in the case of other persons such as companies or firms or any association of individuals, etc., by whatever name called, booked in its name or booked in the name of its associated entities or related enterprises, shall be considered as one allottee only.

### **Structural Defect**

In case any structural defect or any other defect in workmanship, quality or provision of services or any other obligations of the promoter as per the agreement for sale relating to such development is brought to the notice of the promoter within a period of five years by the allottee from the date of handing over possession, it shall be the duty of the promoter to rectify such defects without further charge, within thirty days, and in the event of promoter's failure to rectify such defects within such time, the aggrieved allottees shall be entitled to receive appropriate compensation in the manner as provided under the Act.

### **Obligations of promoter in case of transfer of a real estate project to a third party**

The promoter shall not transfer or assign his majority rights and liabilities in respect of a real estate project to a third party without obtaining prior written consent from two-third allottees, except the promoter, and without the prior written approval of the Authority.

However such transfer or assignment shall not affect the allotment or sale of the apartments, plots or buildings as the case may be, in the real estate project made by the erstwhile promoter.

The allottee, irrespective of the number of apartments or plots, as the case may be, booked by him or booked in the name of his family, or in the case of other persons such as companies or firms or any association of individuals, by whatever name called, booked in its name or booked in the name of its associated entities or related enterprises, shall be considered as one allottee only.

On the transfer or assignment being permitted by the allottees and the authority, the intending promoter shall be required to independently comply with all the pending obligations under the provisions of the Act or the rules and regulations made thereunder, and the pending obligations as per the agreement for sale entered into by the erstwhile promoter with the allottees:

Any transfer or assignment permitted shall not result in extension of time to the intending promoter to complete the real estate project and he shall be required to comply with all the pending obligations of the erstwhile promoter, and in case of default, such intending promoter shall be liable to the consequences of breach or delay, as the case may be, as provided under this Act or the rules and regulations made thereunder.

### **Obligations of promoter regarding insurance of real estate project**

The promoter shall obtain all such insurances as may be notified by the appropriate Government, including but not limited to insurance in respect of –

- (i) title of the land and building as a part of the real estate project; and
- (ii) construction of the real estate project.

The promoter shall be liable to pay the premium and charges in respect of the insurance and shall pay the same before transferring the insurance to the association of the allottees.

The insurance shall stand transferred to the benefit of the allottee or the association of allottees, as the case may be, at the time of promoter entering into an agreement for sale with the allottee. On formation of the association of the allottees, all documents relating to the insurance shall be handed over to the association of the allottees.

### **Transfer of title**

The promoter shall execute a registered conveyance deed in favour of the allottee along with the undivided proportionate title in the common areas to the association of the allottees or the competent authority, as the case may be, and hand over the physical possession of the plot, apartment of building, as the case may be, to the allottees and the common areas to the association of the allottees or the competent authority, as the case may be, in a real estate project, and the other title documents pertaining thereto within specified period as per sanctioned plans as provided under the local laws.

Provided that, in the absence of any local law, conveyance deed in favour of the allottee or the association of the allottees or the competent authority, as the case may be, under this section shall be carried out by the promoter within three months from date of issue of occupancy certificate.

After obtaining the occupancy certificate and handing over physical possession to the allottees, it shall be the responsibility of the promoter to handover the necessary documents and plans, including common areas, to the association of the allottees or the competent authority, as the case may be, as per the local laws.

Provided that, in the absence of any local law, the promoter shall handover the necessary documents and plans, including common areas, the association of the allottees or the competent authority, as the case may be, within thirty days after obtaining the occupancy certificate.

### **Return of amount and compensation**

If the promoter fails to complete or is unable to give possession of an apartment, plot or building, –

- (a) in accordance with the terms of the agreement for sale or, as the case may be, duly completed by the date specified therein; or
- (b) due to discontinuance of his business as a developer on account of suspension or revocation of the registration under this Act or for any other reason,

he shall be liable on demand to the allottees, in case the allottee wishes to withdraw from the project, without prejudice to any other remedy available, to return the amount received by him in respect of that apartment, plot, building, as the case may be, with interest at such rate as may be prescribed in this behalf including compensation in the manner as provided under this Act.

Provided that where an allottee does not intend to withdraw from the project, he shall be paid, by the promoter, interest for every month of delay, till the handing over of the possession, at such rate as may be prescribed.

The promoter shall compensate the allottees in case of any loss caused to him due to defective title of the land, on which the project is being developed or has been developed, in the manner as provided under this Act, and the claim for compensation under this subsection shall not be barred by limitation provided under any law for the time being in force.

If the promoter fails to discharge any other obligations imposed on him under this Act or the rules or regulations made thereunder or in accordance with the terms and conditions of the agreement for sale, he shall be liable to pay such compensation to the allottees, in the manner as provided under this Act.

## Functions and Duties of Promoter

| Sl. No. | Obligation/Duty/Section  |
|---------|--|
| 1.      | No promoter shall advertise, market, book, sell or offer for sale, or invite persons to purchase in any manner any plot, apartment or building in any planning area, without registering the real estate project with the Real Estate Regulatory Authority. <b>Section 3(1)</b>  |
| 2.      | Every promoter shall make an application to the Authority for registration of the real estate project in prescribed form and manner. <b>Section 4(1)</b>   |
| 3.      | The promoter shall enclose the prescribed documents along with the application. <b>Section 4(2)</b>  |
| 4.      | The promoter shall also enclose a prescribed declaration along with application. <b>Section 4(2)(I)</b>  |
| 5.      | The promoter shall keep 70% of the amount received from allottees in a separate bank account in a scheduled bank. <b>Section 4(2)(I)(D)</b>  |
| 6.      | The promoter shall withdraw the amounts from the separate account, to cover the cost of the project, in proportion to the percentage of completion of the project. <b>Section 4(2)(I)(D)</b>   |
| 7.      | The promoter shall withdraw the amounts from the separate account after it is certified by an engineer, an architect and a chartered accountant in practice and the withdrawal is in proportion to the percentage of completion of the project. <b>Section 4(2)(I)(D)</b>  |
| 8.      | The promoter shall get his accounts audited within six months after the end of every financial year by a chartered accountant in practice. <b>Section 4(2)(I)(D)</b>   |
| 9.      | The promoter shall furnish a statement of accounts duly certified and signed by auditor verifying that the amounts collected for a particular project have been utilized for the project and the withdrawal has been in compliance with the proportion to the percentage of completion of the project. <b>Section 4(2)(I)(D)</b> |
| 10.     | The promoter shall obtain a registration number and a Login Id and password to the promoter for accessing the website of the Authority and to create his web page and to fill therein the details of the proposed project. <b>Section 5(2)</b>   |
| 11.     | The promoter shall file application for extension of registration in prescribed form and manner before the Authority if the project could not be completed within time due to force majeure. <b>Section 6</b>  |
| 12.     | The promoter shall comply with anything required by or under the Act or the rules or the regulations. <b>Section 7(1)(a)</b>   |
| 13.     | The promoter shall not violate any of the terms or conditions of the approval given by the competent authority. <b>Section 7(1)(b)</b>   |

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| 14.  | The promoter shall not be involved in any kind of unfair practice or irregularities. <b>Section 7(1)(c)</b>  |
| 15.  | The promoter shall respond to the Notice of Revocation, if any, issued by the Authority. <b>Section 7(2)</b>   |
| 16   | The promoter shall follow any further terms and condition imposed by Authority permitting the registration to remain in force, instead of revoking the registration under Section 7(1). <b>Section 7(3)</b>  |
| 17.  | The promoter shall follow the directions issued by the Authority upon revocation of registration, unless right of appeal is exercised. <b>Section 7(4)</b>   |
| 17A. | The promoter shall use the services of only registered real estate agents for sale of apartment, plot or building of any registered project. <b>Section 9(1)</b>   |
| 18.  | The promoter shall create his web page on the website of the Authority and enter all the prescribed details of the proposed project in all the fields for public viewing. <b>Section 11(1)</b>   |
| 19.  | The promoter shall mention prominently the website address of the Authority in all advertisements or prospectus issued or published. <b>Section 11(2)</b>  |
| 20.  | The promoter shall be responsible to make available to the allottee, all the prescribed information at the time of the booking and issue of allotment letter. <b>Section 11(3)</b>   |
| 21.  | The promoter shall be responsible for all obligations, responsibilities and functions under the provisions of this Act or the rules and regulations. <b>Section 11(4)(a)</b>   |
| 22.  | The promoter shall be responsible to obtain the completion certificate or the occupancy certificate, or both, as applicable, from the relevant competent authority. <b>Section 11(4)(b)</b>  |
| 23.  | The promoter shall be responsible to obtain the lease certificate, where the real estate project is developed on a leasehold land. <b>Section 11(4)(c)</b>   |
| 24   | The promoter shall be responsible for providing and maintaining the essential services, on reasonable charges. <b>Section 11(4)(d)</b>   |
| 25.  | The promoter shall enable the formation of an association or society or co-operative society of the allottees. <b>Section 11(4)(e)</b>   |
| 26   | The promoter shall execute a registered conveyance deed of the apartment, plot or building in favour of the allottee. <b>Section 11(4)(f)</b>  |
| 27   | The promoter shall execute a registered conveyance deed of the undivided proportionate title in the common areas to the association of allottees or competent authority. <b>Section 11(4)(f)</b>   |
| 28.  | The promoter shall pay all outgoings until he transfers the physical possession of the real estate project to the allottee or the associations of allottees. <b>Section 11(4)(g)</b>   |
| 29.  | The promoter shall be liable for the cost of any legal proceedings which may be taken up by authority or person for recovery of outstanding outgoings, if not paid by the promoter. <b>Section 11(4)(g) Proviso</b>  |
| 30.  | The promoter shall not mortgage or create a charge on any apartment, plot or building after execution of an agreement for sale. <b>Section 11(4)(h)</b>  |
| 31.  | The promoter may cancel the allotment only in terms of the agreement for sale. <b>Section 11(5)</b>  |
| 32.  | The promoter shall prepare and maintain all details as may be specified, from time to time, by regulations made by the Authority. <b>Section 11(6)</b>   |
| 33.  | The promoter shall be liable to pay compensation to the allottee where he makes an advance or a deposit on the basis of the information contained in the notice advertisement or prospectus, or on the basis of any model apartment, plot or building and sustains any loss or damage by reason of any incorrect, false statement. <b>Section 12</b> |
| 34.  | The promoter shall enter into an agreement for sale and register the same before he accepts a sum more than ten per cent of the cost of the apartment, plot, or building. <b>Section 13(1)</b>   |
| 35.  | The promoter shall ensure that the agreement for sale is in prescribed form and contain specified particulars. <b>Section 13(2)</b>  |

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| 36. | The promoter shall develop and complete the proposed project in accordance with the sanctioned plans, layout plans and specifications as approved by the competent authorities. <b>Section 14(1)</b>   |
| 37. | The promoter shall not make any additions and alterations in the sanctioned plans, layout plans and specifications and the nature of fixtures, fittings and amenities in any apartment, plot or building without the previous consent of the allottee(s) concerned. <b>Section 14(2)(i)</b>  |
| 38  | The promoter shall not make any other alterations or additions in the sanctioned plans, layout plans and specifications of the buildings or the common areas within the project without the previous written consent of at least two-thirds of the allottees. <b>Section 14(2)(ii)</b>   |
| 39. | The promoter shall be obliged to rectify without further charge, within thirty days, any structural defect or any other defect in workmanship, quality or provision of services or any other obligations of the promoter as per the agreement for sale relating to such development brought to the notice by allottee within a period of five years from the date of handing over possession. <b>Section 14(3)</b> |
| 40. | The promoter shall be responsible to pay to the aggrieved allottees appropriate compensation in prescribed manner if he fails to rectify any structural defect or any other defect in workmanship, quality or provision of services or any other obligations of the promoter as per the agreement for sale. <b>Section 14(3)</b>   |
| 41. | The promoter shall not transfer or assign his majority rights and liabilities in respect of a real estate project to a third party without obtaining prior written consent from two-third allottees and without the prior written approval of the Authority. <b>Section 15(1)</b>  |
| 42  | The promoter shall obtain all such insurances in respect of title and construction, as may be notified by the appropriate Government. <b>Section 16(1)</b>   |
| 43. | The promoter shall be liable to pay the premium and charges in respect of the insurance. <b>Section 16(2)</b>  |
| 44. | The promoter shall transfer all benefits of insurance to allottees and/or the association of allottees at the time of promoter entering into an agreement for sale with the allottee. <b>Section 16(3)</b>   |
| 45. | The promoter shall hand over all documents relating to the insurance to the association of the allottees on its formation. <b>Section 16(4)</b>  |
| 46. | The promoter shall execute a registered conveyance deed in favour of the allottee. <b>Section 17(1)</b>  |
| 47. | The promoter shall execute a registered conveyance deed of undivided proportionate title in the common areas to the association of allottees or the competent authority. <b>Section 17(1)</b>  |
| 48. | The promoter shall hand over the physical possession of the plot, apartment of building to the allottee. <b>Section 17(1)</b>  |
| 49. | The promoter shall handover or physical possession of the common areas to the association of allottees or the competent authority. <b>Section 17(1)</b>  |
| 50. | The promoter shall handover the necessary documents and plans, including common areas, to the association of the allottees or the competent authority. <b>Section 17(2)</b>  |
| 51. | The promoter shall on demand by the allottees, return the amount received by in respect of that apartment, plot, building with interest and compensation. <b>Section 18(1)</b>   |
| 52. | The promoter shall compensate the allottees in case of any loss caused to him due to defective title of the land. <b>Section 18(2)</b>   |
| 53. | The promoter shall be liable to pay compensation if he fails to discharge any other obligations imposed on him under this Act or the rules or regulations. <b>Section 18(3)</b>  |
| 54. | The promoter shall be obliged to furnish in writing such information or explanation relating to its Affairs, as the Authority may require from time to time. <b>Section 35(1)</b>  |
| 55. | The promoter shall be responsible to comply with any directions issued by the Authority unless he makes an appeal against such directions. <b>Section 37</b>   |

|     |  |
|-----|--|
| 56. | The promoter shall be liable to pay penalty or interest imposed by the Authority unless he makes an appeal. <b>Section 38(1)</b>   |
| 57. | The promoter shall be liable to a penalty, which may extend up to ten per cent. of the estimated cost of the real estate project, if he contravenes provisions of section 3. <b>Section 59(1)</b>  |
| 58. | The promoter shall be liable to be punished with imprisonment for a term which may extend up to three years or with fine which may extend up to a further ten per cent of the estimated cost of the real estate project, or with both if he does not comply with the orders, decisions or directions issued under Section 3(1). <b>Section 59(2)</b>   |
| 59. | The promoter shall be liable to a penalty, which may extend up to five per cent of the estimated cost of the real estate project, if he provides false information or contravenes the provisions of Section 4. <b>Section 60</b>   |
| 60. | The promoter shall be liable to a penalty which may extend up to five per cent of the estimated cost of the real estate project, if he contravenes any other provisions of this Act. <b>Section 61</b>   |
| 61. | The promoter shall be liable to a penalty for every day during which such default continues, which may cumulatively extend up to five per cent of the estimated cost of the real estate project, if any promoter, who fails to comply with, or contravenes any of the orders or directions of the Authority. <b>Section 63</b>   |
| 62  | The promoter shall be punishable with imprisonment for a term which may extend up to three years or with fine for every day during which such default continues, which may cumulatively extend up to ten per cent of the estimated cost of the real estate project if any promoter, who fails to comply with, or contravenes any of the orders, decisions or directions of the Appellate Tribunal. <b>Section 64</b> |

## RIGHTS AND DUTIES OF ALLOTTEES

Though the Act is pro-consumer, yet it has struck a balance by specifying the duties of the Allottees. Allottees who do not pay their instalments, maintenance dues in time will also be subjected to the rigours of this Act.

Section 19 provides for the various rights and duties of the allottees.

1. The allottee shall be entitled to obtain the information relating to sanctioned plans, layout plans along with the specifications, approved by the competent authority and such other information as provided in the Act or the rules and regulations made thereunder or the agreement for sale signed with the promoter.
2. The allottee shall be entitled to know stage-wise time schedule of completion of the project, including the provisions for water, sanitation, electricity and other amenities and services as agreed to between the promoter and the allottee in accordance with the terms and conditions of the agreement for sale.
3. The allottee shall be entitled to claim the possession of apartment, plot or building, as the case may be, and the association of allottees shall be entitled to claim the possession of the common areas, as per the declaration given by the promoter.
4. The allottee shall be entitled to claim the refund of amount paid along with interest at such rate as may be prescribed and compensation in the manner as provided under the Act, from the promoter, if the promoter fails to comply or is unable to give possession of the apartment, plot or building, as the case may be, in accordance with the terms of agreement for sale or due to discontinuance of his business as a developer on account of suspension or revocation of his registration under the provisions of the Act or the rules or regulations made thereunder.
5. The allottee shall be entitled to have the necessary documents and plans, including that of common areas, after handing over the physical possession of the apartment or plot or building as the case may be, by the promoter.
6. Every allottee, who has entered into an agreement for sale to take an apartment, plot or building as the case may be, shall be responsible to make necessary payments in the manner and within the time as specified in the said agreement for sale and shall pay at the proper time and place, the share of the registration charges, municipal taxes, water and electricity charges, maintenance charges, ground rent, and other charges, if any.
7. The allottee shall be liable to pay interest, at such rate as may be prescribed, for any delay in payment towards any amount or charges to be paid under sub-section (6).

8. The obligations of the allottee under sub-section (6) and the liability towards interest under sub-section (7) may be reduced when mutually agreed to between the promoter and such allottee.
9. Every allottee of the apartment, plot or building as the case may be, shall participate towards the formation of an association or society or cooperative society of the allottees, or a federation of the same.
10. Every allottee shall take physical possession of the apartment, plot or building as the case may be, within a period of two months of the occupancy certificate issued for the said apartment, plot or building, as the case may be.
11. Every allottee shall participate towards registration of the conveyance deed of the apartment, plot or building, as the case may be, as provided under sub-section (1) of section 17 of this Act.

## THE REAL ESTATE REGULATORY AUTHORITY

As stated earlier, though this sector has seen unprecedented growth since Independence, it has remained unregulated till now. We have witnessed that whenever a regulator is appointed for a sector, like SEBI, IRDAI, TRAI etc, it widens the sectors. Accordingly, this act mandates that RERA would be established by each of the State and UT for administering the real estate sector in the respective State/UT. A state can have more than one RERA or two states can have the same authority.

### Establishment and incorporation of Real Estate Regulatory Authority

The appropriate Government shall establish an Authority to be known as the Real Estate Regulatory Authority to exercise the powers conferred on it and to perform the functions assigned to it under the Act.

The appropriate Government of two or more States or Union territories may, if it deems fit, establish one single Authority. Further, the appropriate Government may, if it deems fit, establish more than one Authority in a State or Union territory, as the case may be.

Until the establishment of a Regulatory Authority under this section, the appropriate Government shall, by order, designate any Regulatory Authority or any officer preferably the Secretary of the department dealing with Housing, as the Regulatory Authority for the purposes under the Act. After the establishment of the Regulatory Authority, all applications, complaints or cases pending with the Regulatory Authority designated, shall stand transferred to the Regulatory Authority so established and shall be heard from the stage such applications, complaints or cases are transferred.

The Authority shall be a body corporate by the name aforesaid having perpetual succession and a common seal, with the power, subject to the provisions of the Act, to acquire, hold and dispose of property, both movable and immovable, and to contract, and shall, by the said name, sue or be sued.

### Composition of Authority

The Authority shall consist of a Chairperson and not less than two whole time Members to be appointed by the appropriate Government.

### Qualifications of Chairperson and Members of Authority

The Chairperson and other Members of the Authority shall be appointed by the appropriate Government on the recommendations of a Selection Committee consisting of the Chief Justice of the High Court or his nominee, the Secretary of the Department dealing with Housing and the Law Secretary, in such manner as may be prescribed, from amongst persons having adequate knowledge of and professional experience of at-least twenty years in case of the Chairperson and fifteen years in the case of the Members in urban development, housing, real estate development, infrastructure, economics, technical experts from relevant fields, planning, law, commerce, accountancy, industry, management, social service, public affairs or administration:

It may be noted that a person who is, or has been, in the service of the State Government shall not be appointed as a Chairperson unless such person has held the post of Additional Secretary to the Central Government or any equivalent post in the Central Government or State Government. Further, a person who is, or has been, in the service of the State Government shall not be appointed as a member unless such person has held the post of Secretary to the State Government or any equivalent post in the State Government or Central Government.

## Term of office of Chairperson and Members

1. The Chairperson and Members shall hold office for a term not exceeding five years from the date on which they enter upon their office, or until they attain the age of sixty-five years, whichever is earlier and shall not be eligible for re-appointment.
2. Before appointing any person as a Chairperson or Member, the appropriate Government shall satisfy itself that the person does not have any such financial or other interest as is likely to affect prejudicially his functions as such Member.

## Salary and allowances payable to Chairperson and Members

1. The salary and allowances payable to, and the other terms and conditions of service of, the Chairperson and other Members shall be such as may be prescribed and shall not be varied to their disadvantage during their tenure.
2. The Chairperson or a Member, as the case may be, may,–
  - (a) relinquish his office by giving in writing, to the appropriate Government, notice of not less than three months; or
  - (b) be removed from his office in accordance with the provisions of section 26 of this Act.
3. Any vacancy caused to the office of the Chairperson or any other Member shall be filled-up within a period of three months from the date on which such vacancy occurs.

## Administrative powers of Chairperson

The Chairperson shall have powers of general superintendence and directions in the conduct of the affairs of Authority and he shall, in addition to presiding over the meetings of the Authority, exercise and discharge such administrative powers and functions of the Authority as may be prescribed.

## Removal of Chairperson and Members from office in certain circumstances

Section 26 deals with Removal of Chairperson and Members from office in certain circumstances. Sub-section(1) states that the appropriate Government may, in accordance with the procedure notified, remove from office the Chairperson or other Members, if the Chairperson or such other Member, as the case may be,–

- (a) has been adjudged as an insolvent; or
  - (b) has been convicted of an offence, involving moral turpitude; or
  - (c) has become physically or mentally incapable of acting as a Member; or
  - (d) has acquired such financial or other interest as is likely to affect prejudicially his functions; or
  - (e) has so abused his position as to render his continuance in office prejudicial to the public interest.
- (2) The Chairperson or Member shall not be removed from his office on the ground specified under clause (d) or clause (e) of sub-section (1) except by an order made by the appropriate Government after an inquiry made by a Judge of the High Court in which such Chairperson or Member has been informed of the charges against him and given a reasonable opportunity of being heard in respect of those charges.

## Restrictions on Chairperson or Members on employment after cessation of office

The Chairperson or a Member, ceasing to hold office as such, shall not–

- (a) accept any employment in, or connected with, the management or administration of, any person or organisation which has been associated with any work under this Act, from the date on which he ceases to hold office: However nothing contained in this clause shall apply to any employment under the appropriate Government or a local authority or in any statutory authority or any corporation established by or under any Central, State or provincial Act or a Government Company, as defined under clause (45) of section 2 of the Companies Act, 2013, which is not a promoter as per the provisions of the Act;

- (b) act, for or on behalf of any person or organisation in connection with any specific proceeding or transaction or negotiation or a case to which the Authority is a party and with respect to which the Chairperson or such Member had, before cessation of office, acted for or provided advice to the Authority;
- (c) give advice to any person using information which was obtained in his capacity as the Chairperson or a Member and being unavailable to or not being able to be made available to the public;
- (d) enter into a contract of service with, or accept an appointment to a board of directors of, or accept an offer of employment with, an entity with which he had direct and significant official dealings during his term of office as such.
- (e) The Chairperson and Members shall not communicate or reveal to any person any matter which has been brought under his consideration or known to him while acting as such.

### Officers and other employees of Authority

The appropriate Government may, in consultation with the Authority appoint such officers and employees as it considers necessary for the efficient discharge of their functions under the Act who would discharge their functions under the general superintendence of the Chairperson.

The salary and allowances payable to, and the other terms and conditions of service of, the officers and of the employees of the Authority appointed shall be such as may be prescribed.

### Meetings of Authority

1. The Authority shall meet at such places and times, and shall follow such rules of procedure in regard to the transaction of business at its meetings, (including quorum at such meetings), as may be specified by the regulations made by the Authority.
2. If the Chairperson for any reason, is unable to attend a meeting of the Authority, any other Member chosen by the Members present amongst themselves at the meeting, shall preside at the meeting.
3. All questions which come up before any meeting of the Authority shall be decided by a majority of votes by the Members present and voting, and in the event of an equality of votes, the Chairperson or in his absence, the person presiding shall have a second or casting vote.
4. The questions which come up before the Authority shall be dealt with as expeditiously as possible and the Authority shall dispose of the same within a period of sixty days from the date of receipt of the application:

However where any such application could not be disposed of within the said period of sixty days, the Authority shall record its reasons in writing for not disposing of the application within that period.

### Filing of complaints with the Authority or the adjudicating officer

Any aggrieved person may file a complaint with the Authority or the adjudicating officer, as the case may be, for any violation or contravention of the provisions of the Act or the rules and regulations made thereunder against any promoter allottee or real estate agent, as the case may be.

It may be noted that "person" shall include the association of allottees or any voluntary consumer association registered under any law for the time being in force.

### Functions of Authority for promotion of real estate sector

The Authority shall in order to facilitate the growth and promotion of a healthy, transparent, efficient and competitive real estate sector make recommendations to the appropriate Government of the competent authority, as the case may be, on,-

- protection of interest of the allottees, promoter and real estate agent;
- creation of a single window system for ensuring time bound project approvals and clearances for timely completion of the project;

- creation of a transparent and robust grievance redressal mechanism against acts of omission and commission of competent authorities and their officials;
- measures to encourage investment in the real estate sector including measures to increase financial assistance to affordable housing segment;
- measures to encourage construction of environmentally sustainable and affordable housing, promoting standardisation and use of appropriate construction materials, fixtures, fittings and construction techniques;
- measures to encourage grading of projects on various parameters of development including grading of promoters;
- – measures to facilitate amicable conciliation of disputes between the promoters and the allottees through dispute settlement forums set up by the consumer or promoter associations;
- measures to facilitate digitization of land records and system towards conclusive property titles with title guarantee;
- to render advice to the appropriate Government in matters relating to the development of real estate sector;
- any other issue that the Authority may think necessary for the promotion of the real estate sector.

### **Advocacy and awareness measures**

The appropriate Government may, while formulating a policy on real estate sector (including review of laws related to real estate sector) or any other matter, make a reference to the Authority for its opinion on possible effect, of such policy or law on real estate sector and on the receipt of such a reference, the Authority shall within a period of sixty days of making such reference, give its opinion to the appropriate Government which may thereafter take further action as it deems fit.

The opinion given by the Authority shall not be binding upon the appropriate Government in formulating such policy or laws.

The Authority shall take suitable measures for the promotion of advocacy, creating awareness and imparting training about laws relating to real estate sector and policies.

### **Functions of Authority**

The functions of the Authority shall include–

- to register and regulate real estate projects and real estate agents registered under the Act;
- to publish and maintain a website of records, for public viewing, of all real estate projects for which registration has been given, with such details as may be prescribed, including information provided in the application for which registration has been granted;
- to maintain a database, on its website, for public viewing, and enter the names and photographs of promoters as defaulters including the project details, registration for which has been revoked or have been penalised under this Act, with reasons therefor, for access to the general public;
- to maintain a database, on its website, for public viewing, and enter the names and photographs of real estate agents who have applied and registered under this Act, with such details as may be prescribed, including those whose registration has been rejected or revoked;
- to fix through regulations for each areas under its jurisdiction the standard fees to be levied on the allottees or the promoter or the real estate agent, as the case may be;
- to ensure compliance of the obligations cast upon the promoters, the allottees and the real estate agents under the Act and the rules and regulations made thereunder;
- to ensure compliance of its regulations or orders or directions made in exercise of its powers under the Act;
- to perform such other functions as may be entrusted to the Authority by the appropriate Government as may be necessary to carry out the provisions of the Act.

## Powers of Authority to call for information, conduct investigation

Where the Authority considers it expedient to do so, on a complaint or suo motu, relating to the Act or the rules of regulations made thereunder, it may, by order in writing and recording reasons therefor call upon any promoter or allottee or real estate agent, as the case may be, at any time to furnish in writing such information or explanation relating to its affairs as the Authority may require and appoint one or more persons to make an inquiry in relation to the affairs of any promoter or allottee or the real estate agent, as the case may be.

Notwithstanding anything contained in any other law for the time being in force, while exercising the powers, the Authority shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit, in respect of the following matters, namely:-

- (i) the discovery and production of books of account and other documents, at such place and at such time as may be specified by the Authority;
- (ii) summoning and enforcing the attendance of persons and examining them on oath;
- (iii) issuing commissions for the examination of witnesses or documents;
- (iv) any other matter which may be prescribed.

## Power to issue interim orders

Where during an inquiry, the Authority is satisfied that an act in contravention of the Act, or the rules and regulations made thereunder, has been committed and continues to be committed or that such act is about to be committed, the Authority may, by order, restrain any promoter, allottee or real estate agent from carrying on such act until the conclusion of such inquiry or until further orders, without giving notice to such party, where the Authority deems it necessary.

## Powers of Authority to issue directions

The Authority may, for the purpose of discharging its functions under the provisions of this Act or rules or regulations made thereunder, issue such directions from time to time, to the promoters or allottees or real estate agents, as the case may be, as it may consider necessary and such directions shall be binding on all concerned.

## Powers of Authority

1. The Authority shall have powers to impose penalty or interest, in regard to any contravention of obligations cast upon the promoters, the allottees and the real estate agents, under this Act or the rules and the regulations made thereunder.
2. The Authority shall be guided by the principles of natural justice and, subject to the other provisions of this Act and the rules made thereunder, the Authority shall have powers to regulate its own procedure.
3. Where an issue is raised relating to agreement, action, omission, practice or procedure that-
  - (a) has an appreciable prevention, restriction or distortion of competition in connection with the development of a real estate project; or
  - (b) has effect of market power of monopoly situation being abused for affecting interest of allottees adversely, then the Authority, may suo motu, make reference in respect of such issue to the Competition Commission of India.

## Rectification of orders

The Authority may, at any time within a period of two years from the date of the order made under the Act, with a view to rectifying any mistake apparent from the record, amend any order passed by it, and shall make such amendment, if the mistake is brought to its notice by the parties.

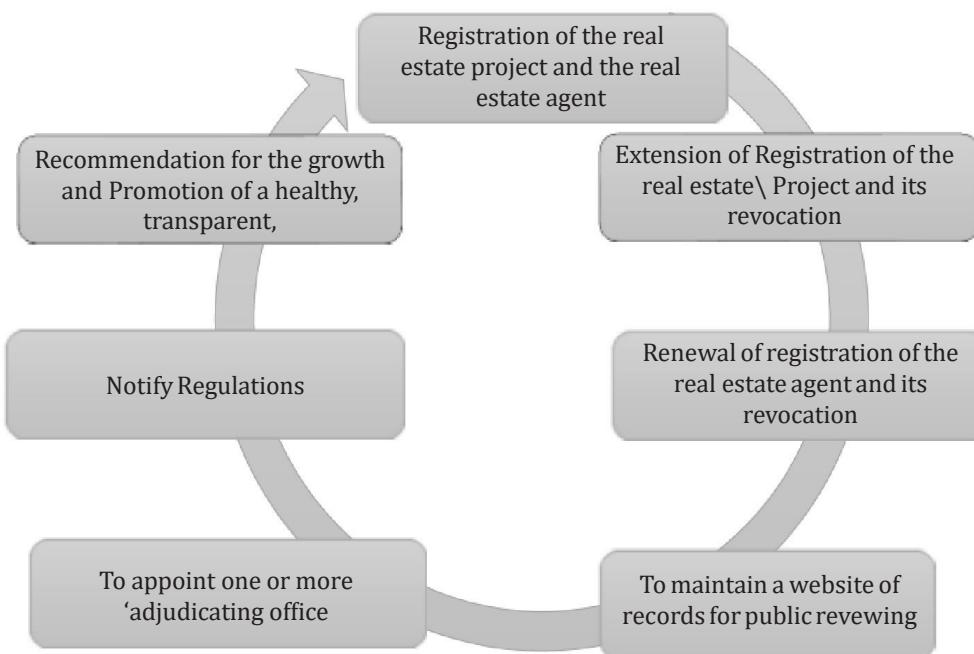
It may be noted that no such amendment shall be made in respect of any order against which an appeal has been preferred under the Act:

## Recovery of interest or penalty or compensation and enforcement of order, etc.

If a promoter or an allottee or a real estate agent, as the case may be, fails to pay any interest or penalty or compensation imposed on him, by the adjudicating officer or the Regulatory Authority or the Appellate Authority, as the case may be, under this Act or the rules and regulations made thereunder, it shall be recoverable from such promoter or allottee or real estate agent, in such manner as may be prescribed as an arrears of land revenue.

If any adjudicating officer or the Regulatory Authority or the Appellate Tribunal, as the case may be, issues any order or directs any person to do any act, or refrain from doing any act, which it is empowered to do under this Act or the rules or regulations made thereunder, then in case of failure by any person to comply with such order or direction, the same shall be enforced, in such manner as may be prescribed.

## Responsibilities of the 'Regulatory Authority'



## CENTRAL ADVISORY COUNCIL

### Establishment of Central Advisory Council

1. The Central Government may, by notification, establish with effect from such date as it may specify in such notification, a Council to be known as the Central Advisory Council.
2. The Minister to the Government of India in charge of the Ministry of the Central Government dealing with Housing shall be the ex officio Chairperson of the Central Advisory Council.
3. The Central Advisory Council shall consist of representatives of the Ministry of Finance, Ministry of Industry and Commerce, Ministry of Urban Development, Ministry of Consumer Affairs, Ministry of Corporate Affairs, Ministry of Law and Justice, Niti Aayog, National Housing Bank, Housing and Urban Development Corporation, five representatives of State Governments to be selected by rotation, five representatives of the Real Estate Regulatory Authorities to be selected by rotation, and any other Central Government department as notified.
4. The Central Advisory Council shall also consist of not more than ten members to represent the interests of real estate industry, consumers, real estate agents, construction labourers, non-governmental organisations and academic and research bodies in the real estate sector.

## Functions of Central Advisory Council

The Central Advisory Council is required to advise the Central Government on matters relating to implementation of the Act, questions of policy, protection of consumer interest, foster growth and development of the real estate sector, and other matters as may be assigned to it by the Central Government.

## THE REAL ESTATE APPELLATE TRIBUNAL

Real Estate Appellate Tribunal (REAT) is to be formed by appropriate government to ensure faster resolution of disputes. Parties aggrieved by the RERA order can appeal before REAT and REAT has to adjudicate such cases within 60 days. Civil Courts have been prevented from exercising jurisdiction on such matters. If any of the parties is not satisfied with the REAT order they can file an appeal against the REAT order to the High Court within 60 days.

## Establishment of Real Estate Appellate Tribunal

1. The appropriate Government shall, establish an Appellate Tribunal to be known as the – (name of the State/ Union territory) Real Estate Appellate Tribunal.
2. The appropriate Government may, if it deems necessary, establish one or more benches of the Appellate Tribunal, for various jurisdictions, in the State or Union territory, as the case may be.
3. Every bench of the Appellate Tribunal shall consist of at least one Judicial Member and one Administrative or Technical Member.
4. The appropriate Government of two or more States or Union territories may, if it deems fit, establish one single Appellate Tribunal.
5. Any person aggrieved by any direction or decision or order made by the Authority or by an adjudicating officer under the Act may prefer an appeal before the Appellate Tribunal having jurisdiction over the matter.

It may be noted that where a promoter files an appeal with the Appellate Tribunal, it shall not be entertained, without the promoter first having deposited with the Appellate Tribunal atleast thirty per cent. of the penalty, or such higher percentage as may be determined by the Appellate Tribunal, or the total amount to be paid to the allottee including interest and compensation imposed on him, if any, or with both, as the case may be, before the said appeal is heard.

“Person” shall include the association of allottees or any voluntary consumer association registered under any law for the time being in force.

## Application for settlement of disputes and appeals to Appellate Tribunal

Section 44 of the Act deals with Application for settlement of disputes and appeals to Appellate Tribunal. It provides that:

The appropriate Government or the competent authority or any person aggrieved by any direction or order or decision of the Authority or the adjudicating officer may prefer an appeal to the Appellate Tribunal.

Every appeal made to the Appellate Tribunal shall be preferred within a period of sixty days from the date on which a copy of the direction or order or decision made by the Authority or the adjudicating officer is received by the appropriate Government or the competent authority or the aggrieved person and it shall be in such form and accompanied by such fee, as may be prescribed.

The Appellate Tribunal may entertain any appeal after the expiry of sixty days if it is satisfied that there was sufficient cause for not filling it within that period.

On receipt of an appeal, the Appellate Tribunal may after giving the parties an opportunity of being heard, pass such orders, including interim orders, as it thinks fit.

The Appellate Tribunal shall send a copy of every order made by it to the parties and to the Authority or the adjudicating officer, as the case may be.

The appeal shall be dealt with by it as expeditiously as possible and endeavour shall be made by it to dispose of the appeal within a period of sixty days from the date of receipt of appeal:

Provided that where any such appeal could not be disposed of within the said period of sixty days, the Appellate Tribunal shall record its reasons in writing for not disposing of the appeal within that period.

The Appellate Tribunal may, for the purpose of examining the legality or propriety or correctness of any order or decision of the Authority or the adjudicating officer, on its own motion or otherwise, call for the records relevant to disposing of such appeal and make such orders as it thinks fit.

### **Composition of Appellate Tribunal**

The Appellate Tribunal shall consist of a Chairperson and not less than two whole time Members of which one shall be a Judicial member and other shall be a Technical or Administrative Member.

### **Qualifications for appointment of Chairperson and Members**

A person shall not be qualified for appointment as the Chairperson or a Member of the Appellate Tribunal unless he,-

in the case of Chairperson, is or has been a Judge of a High Court; and

- (a) in the case of a Judicial Member he has held a judicial office in the territory of India for at least fifteen years or has been a member of the Indian Legal Service and has held the post of Additional Secretary of that service or any equivalent post, or has been an advocate for at least twenty years with experience in dealing with real estate matters; and
- (b) in the case of a Technical or Administrative Member, he is a person who is well-versed in the field of urban development, housing, real estate development, infrastructure, economics, planning, law, commerce, accountancy, industry, management, public affairs or administration and possesses experience of at least twenty years in the field or who has held the post in the Central Government, or a State Government equivalent to the post of Additional Secretary to the Government of India or an equivalent post in the Central Government or an equivalent post in the State Government.
- (c) The Chairperson of the Appellate Tribunal shall be appointed by the appropriate Government in consultation with the Chief Justice of High Court or his nominee.

The judicial Members and Technical or Administrative Members of the Appellate Tribunal shall be appointed by the appropriate Government on the recommendations of a Selection Committee consisting of the Chief Justice of the High Court or his nominee, the Secretary of the Department handling Housing and the Law Secretary and in such manner as may be prescribed.

### **Term of office of Chairperson and Members**

1. The Chairperson of the Appellate Tribunal or a Member of the Appellate Tribunal shall hold office, as such for a term not exceeding five years from the date on which he enters upon his office, but shall not be eligible for re-appointment:

It may be noted that in case a person, who is or has been a Judge of a High Court, has been appointed as Chairperson of the Tribunal, he shall not hold office after he has attained the age of sixty-seven years.

However no Judicial Member or Technical or Administrative Member shall hold office after he has attained the age of sixty-five years.

2. Before appointing any person as Chairperson or Member, the appropriate Government shall satisfy itself that the person does not have any such financial or other interest, as is likely to affect prejudicially his functions as such member.

## Restrictions on Chairperson or Judicial Member or Technical or Administrative Member on employment after cessation of office

The Chairperson or Judicial Member or Technical or Administrative Member, ceasing to hold office as such shall not:-

- (a) Accept any employment in, or connected with, the management or administration of, any person or organisation which has been associated with any work under this Act, from the date on which he ceases to hold office:  
Provided that nothing contained in this clause shall apply to any employment under the appropriate Government or a local authority or in any statutory authority or any corporation established by or under any Central, State or provincial Act or a Government Company as defined under clause (45) of section 2 of the Companies Act, 2013, which is not a promoter as per the provisions of the Act;
- (b) act, for or on behalf of any person or organisation in connection with any specific proceeding or transaction or negotiation or a case to which the Authority is a party and with respect to which the Chairperson or Judicial Member or Technical or Administrative Member had, before cessation of office, acted for or provided advice to the Authority;
- (c) give advice to any person using information which was obtained in his capacity as the Chairperson or Judicial Member or Technical or Administrative Member and being unavailable to or not being able to be made available to the public;
- (d) enter into a contract of service with, or accept an appointment to a board of directors of, or accept an offer of employment with, an entity with which he had direct and significant official dealings during his term of office as such.

The Chairperson or Judicial Member or Technical or Administrative Member shall not communicate or reveal to any person any matter which has been brought under his consideration or known to him while acting as such.

## Powers of Tribunal

1. The Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908 but shall be guided by the principles of natural justice.
2. Subject to the provisions of this Act, the Appellate Tribunal shall have power to regulate its own procedure.
3. The Appellate Tribunal shall also not be bound by the rules of evidence contained in the Indian Evidence Act, 1872.
4. The Appellate Tribunal shall have, for the purpose of discharging its functions under this Act, the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 in respect of the following matters, namely:-
  - (a) summoning and enforcing the attendance of any person and examining him on oath;
  - (b) requiring the discovery and production of documents;
  - (c) receiving evidence on affidavits;
  - (d) issuing commissions for the examinations of witnesses or documents;
  - (e) reviewing its decisions;
  - (f) dismissing an application for default or directing it ex parte; and
  - (g) any other matter which may be prescribed.
5. All proceedings before the Appellate Tribunal shall be deemed to be judicial proceedings within the meaning of sections 193, 219 and 228 for the purposes of section 196 of the Indian Penal Code, and the Appellate Tribunal shall be deemed to be civil court for the purposes of section 195 and Chapter XXVI of the Code of Criminal Procedure, 1973.

## Right to legal representation

Section 56 deals with Right to legal representation. It provides that

The applicant or appellant may either appear in person or authorise one or more chartered accountants or **company secretaries** or cost accountants or legal practitioners or any of its officers to present his or its case before the Appellate Tribunal or the Regulatory Authority or the adjudicating officer, as the case may be.

*Explanation.*—For the purposes of this section,—

- (a) “chartered accountant” means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 or any other law for the time being in force and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (b) “company secretary” means a company secretary as defined in clause (c) of sub-section (1) of section 2 of the Company Secretaries Act, 1980 or any other law for the time being in force and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (c) “cost accountant” means a cost accountant as defined in clause (b) of sub-section (1) of section 2 of the Cost and Works Accountants Act, 1959 or any other law for the time being in force and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;
- (d) “legal practitioner” means an advocate, vakil or an attorney of any High Court, and includes a pleader in practice.

## Orders passed by Appellate Tribunal to be executable as a decree

Every order made by the Appellate Tribunal under this Act shall be executable by the Appellate Tribunal as a decree of civil court, and for this purpose, the Appellate Tribunal shall have all the powers of a civil court.

The Appellate Tribunal may transmit any order made by it to a civil court having local jurisdiction and such civil court shall execute the order as if it were a decree made by the court.

## Appeal to High Court

Any person aggrieved by any decision or order of the Appellate Tribunal may, file an appeal to the High Court, within a period of sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any one or more of the grounds specified in section 100 of the Code of Civil Procedure, 1908.

The High Court may entertain the appeal after the expiry of the said period of sixty days, if it is satisfied that the appellant was prevented by sufficient cause from preferring the appeal in time.

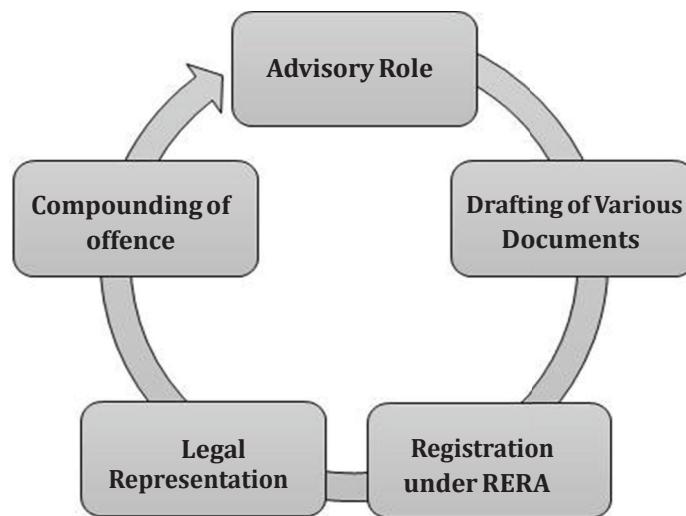
*Explanation.*—“High Court” means the High Court of a State or Union territory where the real estate project is situated. No appeal shall lie against any decision or order made by the Appellate Tribunal with the consent of the parties.

## Real Estate Regulatory Authority and Appellate Tribunal



- Real Estate Regulatory Authority regulate Transactions related to both residential and commercial projects
- Appellate Tribunals be required to adjudicate cases in 60 days
- Regulatory Authorities has to dispose of complaints in 60 days

## ROLE OF COMPANY SECRETARIES



India is witnessing a phenomenal growth and expansion in the corporate sector. The growing demand for specialists in almost every sphere of the corporate functions has led to emergence of professionals who can perform specialized skills with near perfection in their respective fields. A company secretary is one such professional who is responsible for efficient management of the corporate sector. He ensures compliance of various company legislations and advises directors on statutory requirements of the company. Apart from carrying out these functions, he also looks after finance, accounts, legal, secretarial, personnel and administrative functions in private as well as public sectors.

The Companies Act, 2013 confers a special status to Company Secretary as the key managerial personnel and has bracketed him along with Managing Director (MD) or Chief Executive Officer (CEO) or Manager, Whole-time director(s) or Chief Financial Officer (CFO). Every listed company and every other public company having a paid up share capital of ten crore rupees or more has to appoint a whole time Key Managerial Personnel. Whole time Company Secretary is also required to be appointed in other companies which have a paid up share capital of five crore rupees or more.

Almost every kind of organization whose affairs are conducted by boards, councils or other corporate structures, be it a company, trust, association, federation, authority, commission or the like find it useful to appoint a person who holds the qualification of Company Secretaryship in key administrative position. Practising Company Secretaries have been authorized to issue Certificate regarding compliance of conditions of Corporate Governance. Practising Company Secretaries have also been recognized to appear before various Tribunals such as NCLT, NCLAT, Securities Appellate Tribunal, Competition Commission of India, Telecom Disputes Settlement and Appellate Tribunal, Consumer Forums, Tax Tribunals etc. Reserve Bank of India has also recognized the Practising Company Secretaries to undertake Diligence Report for Banks.

The rapid Change in Indian Legislative has brought about a sea change in the role and profile of a company secretary. They are now being seen as corporate development planners. Besides embarking upon traditional areas of practice, Company Secretaries in Practice are increasingly required to advise and guide on legal aspects of business which intimately concern areas such as registration under RERA, production, drafting of various documents, sales, marketing and administration for identifying expansion opportunities, issuing due diligence or comfort certificate, arranging foreign collaborations, amalgamations, mergers, acquisition, takeovers, setting up of subsidiaries and joint ventures within and outside India etc. The new opportunities offered by the growing capital markets and financial services have greatly contributed to the development of the practice side of the profession.

### Company Secretaries - One Stop Professional Advisory Services for Real Estate Projects

Company Secretaries holding Certificate of Practice by becoming an expert in the act can indulge in providing advice in respect of:

- Financial Advisory Services
- Various applicable provision particular on real estate project
- Registration and extension procedure of real estate project with competent authority
- Various obligation, functions and duties of promoter in a real estate project
- Penal Provisions under the Act
- Funding Options for Real Estate Project
- Taxation aspects for Real Estate Project
- Legal & Regulatory Compliances

### **Company Secretaries – As a Legal Representative**

As per Section 56 of the Act, a Company Secretary holding certificate of practice can appear before Appellate Tribunal or a Regulatory Authority or Adjudicating Officer on behalf of applicant or appellant as the case may be.

Hence a Company Secretary holding certificate of practice can –

- Represent a person (promoter) before any real estate regulatory authority for registration of real estate project,
- Represent a person before real estate appellate tribunal.
- Represent a person before any other competent authority for any other purpose under Real Estate (Regulation and Development) Act, 2016.

## **OFFENCES, PENALTIES AND ADJUDICATION**

### **Punishment prescribed for non-registration of a project under the Act**

As per section 59, where under the Act, it is obligatory for the promoter to register a project with the Authority, and the promoter fails to do the same, he shall be liable to a penalty upto ten percent of the estimated cost of the real estate project.

However, in case the promoter consistently defaults or does not comply with the directions orders of the Authority as regards registration of the project with the Authority, he shall be liable to additional fine of ten percent of the estimated cost of the real estate project or imprisonment upto 3 years or both.

### **Penalty for contravention of section 4(Application for registration of real estate projects)**

If any promoter provides false information or contravenes the provisions of section 4, he shall be liable to a penalty which may extend up to five per cent of the estimated cost of the real estate project, as determined by the Authority.

### **Penalty for contravention of other provisions of the Act**

If any promoter contravenes any other provisions of the Act, other than that provided under section 3 or section 4, or the rules or regulations made thereunder, he shall be liable to a penalty which may extend up to five per cent. of the estimated cost of the real estate project as determined by the Authority.

### **Penalty for non-registration and contravention under sections 9 and 10**

If any real estate agent fails to comply with or contravenes the provisions of section 9 or section 10 he shall be liable to a penalty of ten thousand rupees for every day during which such default continues, which may cumulatively extend up to five per cent of the cost of plot, apartment or buildings, as the case may be, of the real estate project, for which the sale or purchase has been facilitated as determined by the Authority.

### **Penalty for failure to comply with orders of Authority by promoter**

If any promoter, who fails to comply with, or contravenes any of the orders or directions of the Authority, he shall be liable to a penalty for every day during which such default continues, which may cumulatively extend up to five per cent., of the estimated cost of the real estate project as determined by the Authority.

### **Penalty for failure to comply with orders of Appellate Tribunal by promoter**

If any promoter, who fails to comply with, or contravenes any of the orders, decisions or directions of the Appellate Tribunal, he shall be punishable with imprisonment for a term which may extend up to three years or with fine for every day during which such default continues, which may cumulatively extend up to ten per cent. of the estimated cost of the real estate project, or with both.

### **Penalty for failure to comply with orders of Authority by real estate agent**

If any real estate agent, who fails to comply with, or contravenes any of the orders or directions of the Authority, he shall be liable to a penalty for every day during which such default continues, which may cumulatively extend up to five per cent., of the estimated cost of plot, apartment or building, as the case may be, of the real estate project, for which the sale or purchase has been facilitated and as determined by the Authority.

### **Penalty for failure to comply with orders of Appellate Tribunal by real estate agent**

If any real estate agent, who fails to comply with, or contravenes any of the orders, decisions or directions of the Appellate Tribunal, he shall be punishable with imprisonment for a term which may extend up to one year or with fine for every day during which such default continues, which may cumulatively extend up to ten per cent. of the estimated cost of plot, apartment or building, as the case may be, of the real estate project, for which the sale or purchase has been facilitated, or with both.

### **Penalty for failure to comply with orders of Authority by allottee**

If any allottee, who fails to comply with, or contravenes any of the orders, decisions or directions of the Authority he shall be liable to a penalty for the period during which such default continues, which may cumulatively extend up to five per cent. of the plot, apartment or building cost, as the case may be, as determined by the Authority.

### **Penalty for failure to comply with orders of Appellate Tribunal by allottee**

If any allottee, who fails to comply with, or contravenes any of the orders or directions of the Appellate Tribunal, as the case may be, he shall be punishable with imprisonment for a term which may extend up to one year or with fine for every day during which such default continues, which may cumulatively extend up to ten per cent of the plot, apartment or building cost, as the case may be, or with both.

### **Offences by companies**

Where an Offence under the Act has been committed by a company, every person who, at the time, the offence was committed was in charge of, or was responsible to the company for the conduct of, the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly -

However nothing contained in this sub-section, shall render any such person liable to any punishment under the Act if he proves that the offence was committed without his knowledge or that he had exercised all due diligence to prevent the commission of such offence.

Where an offence under the Act has been committed by a company, and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

*Explanation.-*

- (a) "company" means any body corporate and includes a firm, or other association of individuals; and
- (b) "director" in relation to a firm, means a partner in the firm.

### **Compounding of offences**

Notwithstanding anything contained in the Code of Criminal Procedure, 1973, if any person is punished with imprisonment under the Act, the punishment may, either before or after the institution of the prosecution, be compounded by the court on such terms and conditions and on payment of such sums as may be prescribed.

However the sum prescribed shall not, in any case, exceed the maximum amount of the fine which may be imposed for the offence so compounded.

### **Power to adjudicate**

For the purpose of adjudging compensation under sections 12, 14, 18 and section 19 (Section 12 deals with obligations of promoter regarding veracity of the advertisement or prospectus, Section 14 deals with Adherence to sanctioned plans and project specifications by the promoter, Section 18 deals with Return of amount and compensation, Section 19 deals with Rights and duties of allottees), the Authority shall appoint in consultation with the appropriate Government one or more judicial officer as deemed necessary, who is or has been a District Judge to be an adjudicating officer for holding an inquiry in the prescribed manner, after giving any person concerned a reasonable opportunity of being heard.

Any person whose complaint in respect of matters covered under section(s) 12, 14, 18 and section 19 is pending before the Consumer Disputes Redressal Forum or the Consumer Disputes Redressal Commission or the National Consumer Redressal Commission, established under section 9 of the Consumer Protection Act, 1986, on or before the commencement of the Act, he may, with the permission of such Forum or Commission, as the case may be, withdraw the complaint pending before it and file an application before the adjudicating officer under this Act.

The application for adjudging compensation shall be dealt with by the adjudicating officer as expeditiously as possible and dispose of the same within a period of sixty days from the date of receipt of the application. Where any such application could not be disposed of within the said period of sixty days, the adjudicating officer shall record his reasons in writing for not disposing of the application within that period.

While holding an inquiry the adjudicating officer shall have power to summon and enforce the attendance of any person acquainted with the facts and circumstances of the case to give evidence or to produce any document which in the opinion of the adjudicating officer, may be useful for or relevant to the subject matter of the inquiry and if, on such inquiry, he is satisfied that the person has failed to comply with the provisions of any of the sections i.e., sections 12, 14, 18 and section 19, he may direct to pay such compensation or interest, as the case may be, as he thinks fit in accordance with the provisions of any of those sections.

### **Bar of jurisdiction**

No civil court shall have jurisdiction to entertain any suit or proceeding in respect of any matter which the Authority or the Adjudicating officer or the Appellate Tribunal is empowered by or under the Act to determine and no injunction shall be granted by any court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under the Act.

## **SPECIMEN AGREEMENT FOR SALE TO BE EXECUTED BETWEEN THE PROMOTER AND THE ALLOTTEE**

This Agreement for Sale ("Agreement") executed on this \_\_\_\_\_ (Date) day of \_\_\_\_\_ (Month), 20\_\_\_\_\_,

### **By and Between**

#### **[If the promoter is a company]**

\_\_\_\_\_, (CIN no.\_\_\_\_\_), a company incorporated under the provisions of the Companies Act, [1956 or 2013, as the case may be], having its registered office at \_\_\_\_\_ and its corporate office at \_\_\_\_\_ (PAN\_\_\_\_\_), represented by its authorized signatory \_\_\_\_\_ (Aadhar no.\_\_\_\_\_) authorized vide board resolution dated \_\_\_\_\_ hereinafter referred to as the "Promoter" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include its successor-in-interest, and permitted assigns).

[OR]

#### **[If the promoter is a Partnership firm]**

\_\_\_\_\_, a partnership firm registered under the Indian Partnership Act, 1932, having its principal place of business at \_\_\_\_\_, (PAN\_\_\_\_\_), represented by its authorized Partner \_\_\_\_\_, (Aadhar no.\_\_\_\_\_) authorized vide \_\_\_\_\_, hereinafter referred to as the "Promoter" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include the partners or partner for the time being of the said firm, the survivor or survivors of them and their heirs, executors and administrators of the last surviving partner and his/her/their assigns).

[OR]

#### **[If the promoter is an Individual]**

Mr. / Ms. \_\_\_\_\_, (Aadhar no.\_\_\_\_\_) son / daughter of \_\_\_\_\_, aged about \_\_\_\_\_, residing at \_\_\_\_\_, (PAN\_\_\_\_\_), hereinafter called the "Promoter" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include his/her heirs, executors, administrators, successors-in-interest and permitted assigns).

AND

#### **[If the Allottee is a company]**

\_\_\_\_\_, (CIN no.\_\_\_\_\_) a company incorporated under the provisions of the Companies Act, [1956 or 2013, as the case may be], having its registered office at \_\_\_\_\_, (PAN\_\_\_\_\_) , represented by its authorized signatory, \_\_\_\_\_, (Aadhar no.\_\_\_\_\_) duly authorized vide board resolution dated, hereinafter referred to as the "Allottee" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include its successor-in-interest, and permitted assigns).

[OR]

#### **[If the Allottee is a Partnership]**

\_\_\_\_\_, a partnership firm registered under the Indian Partnership Act, 1932, having its principal place of business at \_\_\_\_\_, (PAN\_\_\_\_\_), represented by its authorized partner, \_\_\_\_\_, (Aadhar no.\_\_\_\_\_) authorized vide \_\_\_\_\_, hereinafter referred to as the "Allottee" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include the partners or partner for the time being of the said firm, the survivor or survivors of them and their heirs, executors and administrators of the last surviving partner and his/her/their assigns).

[OR]

#### **[If the Allottee is an Individual]**

Mr. / Ms. \_\_\_\_\_, (Aadhar no.\_\_\_\_\_) son / daughter of \_\_\_\_\_, aged about \_\_\_\_\_, residing at \_\_\_\_\_

, (PAN\_\_\_\_\_), hereinafter called the "Allottee" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and include his/her heirs, executors, administrators, successors-in-interest and permitted assigns).

[OR]

### [If the Allottee is a HUF]

Mr.\_\_\_\_\_, (Aadhar no.\_\_\_\_\_) son of\_\_\_\_\_aged about\_\_\_\_for self and as the Karta of the Hindu Joint Mitakshara Family known as\_\_\_\_\_HUF, having its place of business / residence at\_\_\_\_, (PAN\_\_\_\_\_) , hereinafter referred to as the "**Allottee**" (which expression shall unless repugnant to the context or meaning thereof be deemed to mean and the members or member for the time being of the said HUF, and their respective heirs, executors, administrators and permitted assigns).

[Please insert details of other allottee(s), in case of more than one allottee]

The Promoter and Allottee shall hereinafter collectively be referred to as the "Parties" and individually as a "Party".

### DEFINITIONS

For the purpose of this Agreement for Sale, unless the context otherwise requires,-

- (a) "Act" means the Real Estate (Regulation and Development) Act, 2016 (16 of 2016);
- (b) "appropriate Government" means the Central Government;
- (c) "Rules" means the Real Estate (Regulation and Development) (General) Rules, 2016 made under the Real Estate(Regulation and Development) Act, 2016;
- (d) "Regulations" means the Regulations made under the Real Estate (Regulation and Development Act, 2016;
- (e) "section" means a section of the Act.

### WHEREAS

- (A) The Promoter is the absolute and lawful owner of [khasra nos./ survey nos.] [Please insert land details as per local laws]\_\_\_\_\_totally admeasuring\_\_\_\_ square meters situated at\_\_\_\_in Tehsil & District\_\_\_\_ ("Said Land") vide sale deed(s) dated\_\_\_\_registered as documents no.\_\_\_\_at the office of the Sub-Registrar;

[OR]

\_\_\_\_ ("Owner") is the absolute and lawful owner of [khasra nos./ survey nos.] [Please insert land details as per local laws]\_\_\_\_\_totally admeasuring square meters situated at

\_\_\_\_ in Tehsil & District\_\_\_\_ ("Said Land") vide sale deed(s) dated\_\_\_\_registered as documents no.\_\_\_\_at the office of the Sub-Registrar. The Owner and the Promoter have entered into a [collaboration /development / joint development] agreement dated \_\_\_\_\_ registered as document no.\_\_\_\_\_at the office of the Sub-Registrar;

- (B) The Said Land is earmarked for the purpose of building a [commercial/residential/ any other purpose] project, comprising\_\_\_\_ multistoried apartment buildings and [insert any other components of the Projects] and the said project shall be known as '\_\_\_\_' ("Project");

[OR]

- (C) The Said Land is earmarked for the purpose of plotted development of a [commercial/residential/any other purpose] project, comprising\_\_\_\_ plots and [insert any other components of the Projects] and the said project shall be known as '\_\_\_\_' ("Project");

Provided that where land is earmarked for any institutional development the same shall be used for those purposes only and no commercial/residential development shall be permitted unless it is a part of the plan approved by the competent authority;

- (D) The Promoter is fully competent to enter into this Agreement and all the legal formalities with respect to the

right, title and interest of the Promoter regarding the Said Land on which Project is to be constructed have been completed;

The \_\_\_\_\_ [Please insert the name of the concerned competent authority] has granted the commencement certificate to develop the Project vide approval dated bearing registration no.\_\_\_\_;

(E) The Promoter has obtained the final layout plan, sanctioned plan, specifications and approvals for the Project and also for the apartment, plot or building, as the case may be, from \_\_\_\_\_

\_\_\_\_\_[Please insert the name of the concerned competent authority]. The Promoter agrees and undertakes that it shall not make any changes to these approved plans except in strict compliance with section 14 of the Act and other laws as applicable;

(F) The Promoter has registered the Project under the provisions of the Act with the \_\_\_\_\_ (Name of Union Territory) Real Estate Regulatory Authority at on \_\_\_\_\_ under registration no.\_\_\_\_;

(G) The Allottee had applied for an apartment in the Project vide application no.\_\_\_\_ dated \_\_\_\_ and has been allotted apartment no.\_\_\_\_ having carpet area of\_\_\_\_ square feet, type

\_\_\_\_\_, on\_\_\_\_ floor in [tower/block/building] no.\_\_\_\_ ("Building") along with garage/covered parking no. admeasuring\_\_\_\_ square feet in the\_\_\_\_\_[Please insert the location of the garage/covered parking], as permissible under the applicable law and of pro rata share in the common areas ("Common Areas") as defined under clause (n) of Section 2 of the Act (hereinafter referred to as the "Apartment" more particularly described in Schedule A and the floor plan of the apartment is annexed hereto and marked as Schedule B);

[OR]

The Allottee had applied for a plot in the Project vide application no.\_\_\_\_ dated \_\_\_\_ and has been allotted plot no.\_\_\_\_ having area of\_\_\_\_ square feet and plot for garage/covered parking admeasuring\_\_\_\_ square feet (if applicable) in the\_\_\_\_\_[Please insert the location of the garage/covered parking], as permissible under the applicable law and of pro rata share in the common areas ("Common Areas") as defined under clause (n) of Section 2 of the Act (hereinafter referred to as the "Plot" more particularly described in Schedule A);

(H) The Parties have gone through all the terms and conditions set out in this Agreement and understood the mutual rights and obligations detailed herein;

(I) \_\_\_\_ [Please enter any additional disclosures/ details];

(J) The Parties hereby confirm that they are signing this Agreement with full knowledge of all the laws, rules, regulations, notifications, etc., applicable to the Project;

(K) The Parties, relying on the confirmations, representations and assurances of each other to faithfully abide by all the terms, conditions and stipulations contained in this Agreement and all applicable laws, are now willing to enter into this Agreement on the terms and conditions appearing hereinafter;

(L) In accordance with the terms and conditions set out in this Agreement and as mutually agreed upon by and between the Parties, the Promoter hereby agrees to sell and the Allottee hereby agrees to purchase the [Apartment/Plot] and the garage/covered parking (if applicable) as specified in para G.

**NOW THEREFORE**, in consideration of the mutual representations, covenants, assurances, promises and agreements contained herein and other good and valuable consideration, the Parties agree as follows:

### 1. TERMS:

1.1 Subject to the terms and conditions as detailed in this Agreement, the Promoter agrees to sell to the Allottee and the Allottee hereby agrees to purchase, the [Apartment/Plot] as specified in para G.

1.2 The Total Price for the [Apartment/Plot] based on the carpet area is Rs. \_\_\_\_\_ (Rupees \_\_\_\_\_ only ("Total Price")) (Give break up and description): Block/Building/Tower no.\_\_\_\_\_ Rate of Apartment per square feet\*

Apartment no. \_\_\_\_\_

Type \_\_\_\_\_

## Floor

Total price (in rupees) \_\_\_\_\_

\*Provide break up of the amounts such as cost of apartment, cost of exclusive balcony or verandah areas, cost of exclusive open terrace areas, proportionate cost of common areas, preferential location charges, taxes, maintenance charges as per para 11 etc., if/as applicable.

[AND] [if/as applicable]

Garage/Covered parking - 1 Price for 1

Garage/Covered parking - 2 Price for 2

### Total price (in rupees)

[OR]

Plot no.

Type \_\_\_\_\_

### Rate of Plot per square feet\*

### Total price (in rupees)

\*Provide break up of the amounts such as cost of plot, property maintenance charges as per para 11 etc., if/as applicable.

[AND] [if/as applicable]

### Total price (in rupees)

*Explanation:* (i) The Total Price above includes the booking amount paid by the allottee to the Promoter towards the

[Apartment/Plot];

(ii) The Total Price above includes Taxes (consisting of tax paid or payable by the Promoter by way of Value Added Tax, Service Tax, and Cess or any other similar taxes which may be levied, in connection with the construction of the Project payable by the Promoter, by whatever name called) up to the date of handing over the possession of the apartment/plot to the allottee and the project to the association of allottees or the competent authority as the case may be, after obtaining the completion certificate.

Provided that in case there is any change / modification in the taxes, the subsequent amount payable by the allottee to the promoter shall be increased/reduced based on such change / modification;

Provided further that if there is any increase in the taxes after the expiry of the scheduled date of completion of the project as per registration with the Authority, which shall include the extension of registration, if any, granted to the said project by the Authority, as per the Act, the same shall not be charged from the allottee;

(iii) The Promoter shall periodically intimate in writing to the Allottee, the amount payable as stated in above and the Allottee shall make payment demanded by the Promoter within the time and in the manner specified therein. In addition, the Promoter shall provide to the Allottee the details of the taxes paid or demanded along with the acts/rules/notifications together with dates from which such taxes/levies etc. have been imposed or become effective:

(iv) The Total Price of [Apartment/Plot] includes recovery of price of land, construction of [not only the Apartment but also the Common Areas, internal development charges, external development charges, taxes, cost of

providing electric wiring, electrical connectivity to the apartment, lift, water line and plumbing, finishing with paint, marbles, tiles, doors, windows, fire detection and firefighting equipment in the common areas, maintenance charges as per para 11 etc. and includes cost for providing all other facilities, amenities and specifications to be provided within the [Apartment/ Plot] and the Project.

- 1.3 The Total Price is escalation-free, save and except increases which the Allottee hereby agrees to pay, due to increase on account of development charges payable to the competent authority and/or any other increase in charges which may be levied or imposed by the competent authority from time to time. The Promoter undertakes and agrees that while raising a demand on the Allottee for increase in development charges, cost/ charges imposed by the competent authorities, the Promoter shall enclose the said notification/order/rule/ regulation to that effect along with the demand letter being issued to the Allottee, which shall only be applicable on subsequent payments. Provided that if there is any new imposition or increase of any development charges after the expiry of the scheduled date of completion of the project as per registration with the Authority, which shall include the extension of registration, if any, granted to the said project by the Authority, as per the Act, the same shall not be charged from the allottee.
- 1.4 The Allottee(s) shall make the payment as per the payment plan set out in Schedule C ("Payment Plan").
- 1.5 The Promoter may allow, in its sole discretion, a rebate for early payments of installments payable by the Allottee by discounting such early payments @% per annum for the period by which the respective installment has been preponed. The provision for allowing rebate and such rate of rebate shall not be subject to any revision/withdrawal, once granted to an Allottee by the Promoter.
- 1.6 It is agreed that the Promoter shall not make any additions and alterations in the sanctioned plans, layout plans and specifications and the nature of fixtures, fittings and amenities described herein at Schedule 'D' and Schedule 'E' (which shall be in conformity with the advertisement, prospectus etc., on the basis of which sale is effected) in respect of the apartment, plot or building, as the case may be, without the previous written consent of the Allottee as per the provisions of the Act. Provided that the Promoter may make such minor additions or alterations as may be required by the Allottee, or such minor changes or alterations as per the provisions of the Act.
- 1.7 [Applicable in case of an apartment] The Promoter shall confirm to the final carpet area that has been allotted to the Allottee after the construction of the Building is complete and the occupancy certificate is granted by the competent authority, by furnishing details of the changes, if any, in the carpet area. The total price payable for the carpet area shall be recalculated upon confirmation by the Promoter. If there is reduction in the carpet area then the Promoter shall refund the excess money paid by Allottee within forty-five days with annual interest at the rate prescribed in the Rules, from the date when such an excess amount was paid by the Allottee. If there is any increase in the carpet area, which is not more than three percent of the carpet area of the apartment, allotted to Allottee, the Promoter may demand that from the Allottee as per the next milestone of the Payment Plan as provided in Schedule C. All these monetary adjustments shall be made at the same rate per square feet as agreed in para 1.2 of this Agreement.
- 1.8 The Promoter agrees and acknowledges, the Allottee shall have the right to the [Apartment/Plot] as mentioned below:
  - (i) The Allottee shall have exclusive ownership of the [Apartment/Plot];
  - (ii) The Allottee shall also have undivided proportionate share in the Common Areas. Since the share / interest of Allottee in the Common Areas is undivided and cannot be divided or separated, the Allottee shall use the Common Areas along with other occupants, maintenance staff etc., without causing any inconvenience or hindrance to them. It is clarified that the promoter shall hand over the common areas to the association of allottees after duly obtaining the completion certificate from the competent authority as provided in the Act;
  - (iii) That the computation of the price of the [Apartment/Plot] includes recovery of price of land, construction of [not only the Apartment but also] the Common Areas, internal development charges, external development charges, taxes, cost of providing electric wiring, electrical connectivity to the apartment, lift, water line and plumbing, finishing with paint, marbles, tiles, doors, windows, fire detection and firefighting equipment in the common areas, maintenance charges as per para 11 etc.

and includes cost for providing all other facilities, amenities and specifications to be provided within the [Apartment/Plot] and the Project;

- (iv) The Allottee has the right to visit the project site to assess the extent of development of the project and his apartment/plot, as the case may be.
- 1.9 It is made clear by the Promoter and the Allottee agrees that the [Apartment/ Plot] along with garage/covered parking shall be treated as a single indivisible unit for all purposes. It is agreed that the Project is an independent, self-contained Project covering the said Land and is not a part of any other project or zone and shall not form a part of and/or linked/combined with any other project in its vicinity or otherwise except for the purpose of integration of infrastructure for the benefit of the Allottee. It is clarified that Project's facilities and amenities shall be available only for use and enjoyment of the Allottees of the Project.
- 1.10 The Promoter agrees to pay all outgoings before transferring the physical possession of the apartment to the Allottees, which it has collected from the Allottees, for the payment of outgoings (including land cost, ground rent, municipal or other local taxes, charges for water or electricity, maintenance charges, including mortgage loan and interest on mortgages or other encumbrances and such other liabilities payable to competent authorities, banks and financial institutions, which are related to the project). If the Promoter fails to pay all or any of the outgoings collected by it from the Allottees or any liability, mortgage loan and interest thereon before transferring the apartment to the Allottees, the Promoter agrees to be liable, even after the transfer of the property, to pay such outgoings and penal charges, if any, to the authority or person to whom they are payable and be liable for the cost of any legal proceedings which may be taken therefor by such authority or person.
- 1.11 The Allottee has paid a sum of Rs.\_\_\_\_ (Rupees\_\_\_\_ only) as booking amount being part payment towards the Total Price of the [Apartment/ Plot] at the time of application the receipt of which the Promoter hereby acknowledges and the Allottee hereby agrees to pay the remaining price of the [Apartment/Plot] as prescribed in the Payment Plan [Schedule C] as may be demanded by the Promoter within the time and in the manner specified therein:

Provided that if the allottee delays in payment towards any amount which is payable, he shall be liable to pay interest at the rate prescribed in the Rules.

## 2. Mode of Payment

Subject to the terms of the Agreement and the Promoter abiding by the construction milestones, the Allottee shall make all payments, on written demand by the Promoter, within the stipulated time as mentioned in the Payment Plan

[Schedule C] through A/c Payee cheque/demand draft/bankers cheque or online payment (as applicable) in favour of ' ' payable at\_\_\_\_\_.

## 3. Compliance of Laws Relating to Remittances

- 3.1 The Allottee, if resident outside India, shall be solely responsible for complying with the necessary formalities as laid down in Foreign Exchange Management Act, 1999, Reserve Bank of India Act, 1934 and the Rules and Regulations made thereunder or any statutory amendment(s) modification(s) made thereof and all other applicable laws including that of remittance of payment acquisition/ sale/transfer of immovable properties in India etc. and provide the Promoter with such permission, approvals which would enable the Promoter to fulfill its obligations under this Agreement. Any refund, transfer of security, if provided in terms of the Agreement shall be made in accordance with the provisions of Foreign Exchange Management Act, 1999 or the statutory enactments or amendments thereof and the Rules and Regulations of the Reserve Bank of India or any other applicable law. The Allottee understands and agrees that in the event of any failure on his/her part to comply with the applicable guidelines issued by the Reserve Bank of India, he/she may be liable for any action under the Foreign Exchange Management Act, 1999 or other laws as applicable, as amended from time to time.
- 3.2 The Promoter accepts no responsibility in regard to matters specified in para 3.1 above. The Allottee shall keep the Promoter fully indemnified and harmless in this regard. Whenever there is any change in the residential status of the Allottee subsequent to the signing of this Agreement, it shall be the sole responsibility of the Allottee to intimate the same in writing to the Promoter immediately and comply with necessary

formalities if any under the applicable laws. The Promoter shall not be responsible towards any third party making payment/remittances on behalf of any Allottee and such third party shall not have any right in the application/allotment of the said apartment applied for herein in any way and the Promoter shall be issuing the payment receipts in favour of the Allottee only.

#### 4. Adjustment/Appropriation of Payments

The Allottee authorizes the Promoter to adjust/appropriate all payments made by him/her under any head(s) of dues against lawful outstanding of the allottee against the [Apartment/Plot], if any, in his/her name and the Allottee undertakes not to object/demand/direct the Promoter to adjust his payments in any manner.

#### 5. Time is Essence

The Promoter shall abide by the time schedule for completing the project as disclosed at the time of registration of the project with the Authority and towards handing over the [Apartment/Plot] to the Allottee and the common areas to the association of allottees or the competent authority, as the case may be.

#### 6. Construction of the Project/Apartment

The Allottee has seen the proposed layout plan, specifications, amenities and facilities of the [Apartment/Plot] and accepted the floor plan, payment plan and the specifications, amenities and facilities [annexed along with this Agreement] which has been approved by the competent authority, as represented by the Promoter. The Promoter shall develop the Project in accordance with the said layout plans, floor plans and specifications, amenities and facilities. Subject to the terms in this Agreement, the Promoter undertakes to strictly abide by such plans approved by the competent Authorities and shall also

strictly abide by the bye-laws, FAR and density norms and provisions prescribed by the \_\_\_\_\_ [Please insert the relevant State laws] and shall not have an option to make any variation /alteration / modification in such plans, other than in the manner provided under the Act, and breach of this term by the Promoter shall constitute a material breach of the Agreement.

#### 7. Possession of the Apartment/Plot:

7.1 Schedule for possession of the said [Apartment/Plot] - The Promoter agrees and understands that timely delivery of possession of the [Apartment/Plot] to the allottee and the common areas to the association of allottees or the competent authority, as the case may be, is the essence of the Agreement. The Promoter assures to hand over possession of the [Apartment/Plot] along with ready and complete common areas with all specifications, amenities and facilities of the project in place on\_\_\_\_, unless there is delay or failure due to war, flood, drought, fire, cyclone, earthquake or any other calamity caused by nature affecting the regular development of the real estate project ("Force Majeure"). If, however, the completion of the Project is delayed due to the Force Majeure conditions then the Allottee agrees that the Promoter shall be entitled to the extension of time for delivery of possession of the [Apartment/ Plot], provided that such Force Majeure conditions are not of a nature which make it impossible for the contract to be implemented. The Allottee agrees and confirms that, in the event it becomes impossible for the Promoter to implement the project due to Force Majeure conditions, then this allotment shall stand terminated and the Promoter shall refund to the Allottee the entire amount received by the Promoter from the allotment within 45 days from that date. The promoter shall intimate the allottee about such termination at least thirty days prior to such termination. After refund of the money paid by the Allottee, the Allottee agrees that he/ she shall not have any rights, claims etc. against the Promoter and that the Promoter shall be released and discharged from all its obligations and liabilities under this Agreement.

7.2 Procedure for taking possession - The Promoter, upon obtaining the occupancy certificate\* from the competent authority shall offer in writing the possession of the [Apartment/Plot], to the Allottee in terms of this Agreement to be taken within two months from the date of issue of occupancy certificate. [Provided that, in the absence of local law, the conveyance deed in favour of the allottee shall be carried out by the promoter within 3 months from the date of issue of occupancy certificate]. The Promoter agrees and undertakes to indemnify the Allottee in case of failure of fulfillment of any of the provisions, formalities, documentation on part of the Promoter. The Allottee, after taking possession, agree(s) to pay the maintenance charges as determined by the Promoter/association of allottees, as the case may be after the issuance of the completion certificate for the project. The promoter shall hand over the occupancy certificate of the apartment/plot, as the case may be, to the allottee at the time of conveyance of the same.

- 7.3 Failure of Allottee to take Possession of [Apartment/Plot] - Upon receiving a written intimation from the Promoter as per para 7.2, the Allottee shall take possession of the [Apartment/Plot] from the Promoter by executing necessary indemnities, undertakings and such other documentation as prescribed in this Agreement, and the Promoter shall give possession of the [Apartment/Plot] to the allottee. In case the Allottee fails to take possession within the time provided in para 7.2, such Allottee shall continue to be liable to pay maintenance charges as specified in para 7.2.
- 7.4 Possession by the Allottee - After obtaining the occupancy certificate and handing over physical possession of the [Apartment/Plot] to the Allottees, it shall be the responsibility of the Promoter to hand over the necessary documents and plans, including common areas, to the association of Allottees or the competent authority, as the case may be, as per the local laws. [Provided that, in the absence of any local law, the promoter shall handover the necessary documents and plans, including common areas, to the association of allottees or the competent authority, as the case may be, within thirty days after obtaining the completion certificate].
- Cancellation by Allottee – The Allottee shall have the right to cancel/withdraw his allotment in the Project as provided in the Act:
- 7.5 Provided that where the allottee proposes to cancel/withdraw from the project without any fault of the promoter, the promoter herein is entitled to forfeit the booking amount paid for the allotment. The balance amount of money paid by the allottee shall be returned by the promoter to the allottee within 45 days of such cancellation.
- 7.6 Compensation – The Promoter shall compensate the Allottee in case of any loss caused to him due to defective title of the land, on which the project is being developed or has been developed, in the manner as provided under the Act and the claim for interest and compensation under this provision shall not be barred by limitation provided under any law for the time being in force.

Except for occurrence of a Force Majeure event, if the promoter fails to complete or is unable to give possession of the [Apartment/Plot] (i) in accordance with the terms of this Agreement, duly completed by the date specified in para 7.1; or (ii) due to discontinuance of his business as a developer on account of suspension or revocation of the registration under the Act; or for any other reason; the Promoter shall be liable, on demand to the allottees, in case the Allottee wishes to withdraw from the Project, without prejudice to any other remedy available, to return the total amount received by him in respect of the [Apartment/Plot], with interest at the rate prescribed in the Rules including compensation in the manner as provided under the Act within forty-five days of it becoming due. Provided that where if the Allottee does not intend to withdraw from the Project, the Promoter shall pay the Allottee interest at the rate prescribed in the Rules for every month of delay, till the handing over of the possession of the [Apartment/Plot], which shall be paid by the promoter to the allottee within forty-five days of it becoming due.

## 8. Representations and Warranties of the Promoter

The Promoter hereby represents and warrants to the Allottee as follows:

- (i) The [Promoter] has absolute, clear and marketable title with respect to the said Land; the requisite rights to carry out development upon the said Land and absolute, actual, physical and legal possession of the said Land for the Project;
- (ii) The Promoter has lawful rights and requisite approvals from the competent Authorities to carry out development of the Project;
- (iii) There are no encumbrances upon the said Land or the Project; [in case there are any encumbrances on the land provide details of such encumbrances including any rights, title, interest and name of party in or over such land]
- (iv) There are no litigations pending before any Court of law or Authority with respect to the said Land, Project or the [Apartment/Plot];
- (v) All approvals, licenses and permits issued by the competent authorities with respect to the Project, said Land and [Apartment/Plot] are valid and subsisting and have been obtained by following due process of law. Further, the Promoter has been and shall, at all times, remain to be in compliance with

all applicable laws in relation to the Project, said Land, Building and [Apartment/Plot] and common areas;

- (vi) The Promoter has the right to enter into this Agreement and has not committed or omitted to perform any act or thing, whereby the right, title and interest of the Allottee created herein, may prejudicially be affected;
- (vii) The Promoter has not entered into any agreement for sale and/or development agreement or any other agreement / arrangement with any person or party with respect to the said Land, including the Project and the said [Apartment/Plot] which will, in any manner, affect the rights of Allottee under this Agreement;
- (viii) The Promoter confirms that the Promoter is not restricted in any manner whatsoever from selling the said [Apartment/Plot] to the Allottee in the manner contemplated in this Agreement;
- (ix) At the time of execution of the conveyance deed the Promoter shall handover lawful, vacant, peaceful, physical possession of the [Apartment/ Plot] to the Allottee and the common areas to the association of allottees or the competent authority, as the case may be;
- (x) The Schedule Property is not the subject matter of any HUF and that no part thereof is owned by any minor and/or no minor has any right, title and claim over the Schedule Property;
- (xi) The Promoter has duly paid and shall continue to pay and discharge all governmental dues, rates, charges and taxes and other monies, levies, impositions, premiums, damages and/or penalties and other outgoings, whatsoever, payable with respect to the said project to the competent Authorities till the completion certificate has been issued and possession of apartment, plot or building, as the case may be, along with common areas (equipped with all the specifications, amenities and facilities) has been handed over to the allottee and the association of allottees or the competent authority, as the case may be;
- (xii) No notice from the Government or any other local body or authority or any legislative enactment, government ordinance, order, notification (including any notice for acquisition or requisition of the said property) has been received by or served upon the Promoter in respect of the said Land and/ or the Project.

## 9. Events of Defaults and Consequences:

9.1 Subject to the Force Majeure clause, the Promoter shall be considered under a condition of Default, in the following events:

- (i) Promoter fails to provide ready to move in possession of the [Apartment/ Plot] to the Allottee within the time period specified in para 7.1 or fails to complete the project within the stipulated time disclosed at the time of registration of the project with the Authority. For the purpose of this para, 'ready to move in possession' shall mean that the apartment shall be in a habitable condition which is complete in all respects including the provision of all specifications, amenities and facilities, as agreed to between the parties, and for which occupation certificate and completion certificate, as the case may be, has been issued by the competent authority;
- (ii) Discontinuance of the Promoter's business as a developer on account of suspension or revocation of his registration under the provisions of the Act or the rules or regulations made thereunder.

9.2 In case of Default by Promoter under the conditions listed above, Allottee is entitled to the following:

- (i) Stop making further payments to Promoter as demanded by the Promoter. If the Allottee stops making payments, the Promoter shall correct the situation by completing the construction milestones and only thereafter the Allottee be required to make the next payment without any interest; or
- (ii) The Allottee shall have the option of terminating the Agreement in which case the Promoter shall be liable to refund the entire money paid by the Allottee under any head whatsoever towards the purchase of the apartment, along with interest at the rate prescribed in the Rules within forty-five days of receiving the termination notice:

Provided that where an Allottee does not intend to withdraw from the project or terminate the Agreement, he shall be paid, by the promoter, interest at the rate prescribed in the Rules, for every month of delay till the handing over of the possession of the [Apartment/Plot], which shall be paid by the promoter to the allottee within forty-five days of it becoming due.

9.3 The Allottee shall be considered under a condition of Default, on the occurrence of the following events:

- (i) In case the Allottee fails to make payments for \_\_\_ consecutive demands made by the Promoter as per the Payment Plan annexed hereto, despite having been issued notice in that regard the allottee shall be liable to pay interest to the promoter on the unpaid amount at the rate prescribed in the Rules;
- (ii) In case of Default by Allottee under the condition listed above continues for a period beyond consecutive months after notice from the Promoter in this regard, the Promoter may cancel the allotment of the [Apartment/ Plot] in favour of the Allottee and refund the money paid to him by the allottee by deducting the booking amount and the interest liabilities and this Agreement shall thereupon stand terminated. Provided that the promoter shall intimate the allottee about such termination at least thirty days prior to such termination.

#### **10. Conveyance of the Said Apartment**

The Promoter, on receipt of Total Price of the [Apartment/Plot] as per para 1.2 under the Agreement from the Allottee, shall execute a conveyance deed and convey the title of the [Apartment/Plot] together with proportionate indivisible share in the Common Areas within 3 months from the date of issuance of the occupancy certificate and the completion certificate, as the case may be, to the allottee. [Provided that, in the absence of local law, the conveyance deed in favour of the allottee shall be carried out by the promoter within 3 months from the date of issue of occupancy certificate]. However, in case the Allottee fails to deposit the stamp duty and/or registration charges within the period mentioned in the notice, the Allottee authorizes the Promoter to withhold registration of the conveyance deed in his/her favour till payment of stamp duty and registration charges to the Promoter is made by the Allottee.

#### **11. Maintenance of the Said Building/Apartment/Project**

The Promoter shall be responsible to provide and maintain essential services in the Project till the taking over of the maintenance of the project by the association of allottees upon the issuance of the completion certificate of the project. The cost of such maintenance has been included in the Total Price of the [Apartment/ Plot].

#### **12. Defect Liability**

It is agreed that in case any structural defect or any other defect in workmanship, quality or provision of services or any other obligations of the Promoter as per the agreement for sale relating to such development is brought to the notice of the Promoter within a period of 5 (five) years by the Allottee from the date of handing over possession, it shall be the duty of the Promoter to rectify such defects without further charge, within 30 (thirty) days, and in the event of Promoter's failure to rectify such defects within such time, the aggrieved Allottees shall be entitled to receive appropriate compensation in the manner as provided under the Act.

#### **13. Right to Enter the Apartment for Repairs**

The Promoter/maintenance agency/association of allottees shall have rights of unrestricted access of all Common Areas, garages/covered parking and parking spaces for providing necessary maintenance services and the Allottee agrees to permit the association of allottees and/or maintenance agency to enter into the [Apartment/Plot] or any part thereof, after due notice and during the normal working hours, unless the circumstances warrant otherwise, with a view to set right any defect.

#### **14. Usage**

**Use of Basement and Service Areas:** The basement(s) and service areas, if any, as located within the \_\_\_ (project name), shall be earmarked for purposes such as parking spaces and services including but not limited to electric sub-station, transformer, DG set rooms, underground water tanks, pump rooms, maintenance and service rooms, fire fighting pumps and equipment's etc. and other permitted uses as per sanctioned plans. The Allottee shall not be permitted to use the services areas and the basements in any manner whatsoever, other than those earmarked as parking spaces, and the same shall be reserved for use by the association of allottees formed by the Allottees for rendering maintenance services.

## 15. General Compliance with Respect to the Apartment

- 15.1 Subject to para 12 above, the Allottee shall, after taking possession, be solely responsible to maintain the [Apartment/Plot] at his/her own cost, in good repair and condition and shall not do or suffer to be done anything in or to the Building, or the [Apartment/Plot], or the staircases, lifts, common passages, corridors, circulation areas, atrium or the compound which may be in violation of any laws or rules of any authority or change or alter or make additions to the [Apartment/Plot] and keep the [Apartment/Plot], its walls and partitions, sewers, drains, pipe and appurtenances thereto or belonging thereto, in good and tenantable repair and maintain the same in a fit and proper condition and ensure that the support, shelter etc. of the Building is not in any way damaged or jeopardized.
- 15.2 The Allottee further undertakes, assures and guarantees that he/she would not put any sign-board / name-plate, neon light, publicity material or advertisement material etc. on the face / facade of the Building or anywhere on the exterior of the Project, buildings therein or Common Areas. The Allottees shall also not change the colour scheme of the outer walls or painting of the exterior side of the windows or carry out any change in the exterior elevation or design. Further the Allottee shall not store any hazardous or combustible goods in the [Apartment/Plot] or place any heavy material in the common passages or staircase of the Building. The Allottee shall also not remove any wall, including the outer and load bearing wall of the [Apartment/Plot].
- 15.3 The Allottee shall plan and distribute its electrical load in conformity with the electrical systems installed by the Promoter and thereafter the association of allottees and/or maintenance agency appointed by association of allottees. The Allottee shall be responsible for any loss or damages arising out of breach of any of the aforesaid conditions.

## 16. Compliance of Laws, Notifications etc. by Parties

The Parties are entering into this Agreement for the allotment of a [Apartment/ Plot] with the full knowledge of all laws, rules, regulations, notifications applicable to the project.

## 17. Additional Constructions

The Promoter undertakes that it has no right to make additions or to put up additional structure(s) anywhere in the Project after the building plan, layout plan, sanction plan and specifications, amenities and facilities has been approved by the competent authority(ies) and disclosed, except for as provided in the Act.

## 18. Promoter shall not Mortgage or Create a Charge

After the Promoter executes this Agreement he shall not mortgage or create a charge on the [Apartment/ Plot/Building] and if any such mortgage or charge is made or created then notwithstanding anything contained in any other law for the time being in force, such mortgage or charge shall not affect the right and interest of the Allottee who has taken or agreed to take such [Apartment/Plot/ Building].

## 19. Apartment Ownership Act (of the Relevant State)

The Promoter has assured the Allottees that the project in its entirety is in accordance with the provisions of the \_\_\_\_\_

[Please insert the name of the state Apartment Ownership Act ]. The Promoter showing compliance of various laws/regulations as applicable in\_\_\_\_\_

## 20. Binding Effect

Forwarding this Agreement to the Allottee by the Promoter does not create a binding obligation on the part of the Promoter or the Allottee until, firstly, the Allottee signs and delivers this Agreement with all the schedules along with the payments due as stipulated in the Payment Plan within 30 (thirty) days from the date of receipt by the Allottee and secondly, appears for registration of the same before the concerned Sub-Registrar\_(specify the address of the Sub-Registrar) as and when intimated by the Promoter. If the Allottee(s) fails to execute and deliver to the Promoter this Agreement within 30 (thirty) days from the date of its receipt by the Allottee and/or appear before the Sub-Registrar for its registration as and when intimated by the Promoter, then the Promoter shall serve a notice to the Allottee for rectifying the default, which if not rectified

within 30 (thirty) days from the date of its receipt by the Allottee, application of the Allottee shall be treated as cancelled and all sums deposited by the Allottee in connection therewith including the booking amount shall be returned to the Allottee without any interest or compensation whatsoever.

## **21. Entire Agreement**

This Agreement, along with its schedules, constitutes the entire Agreement between the Parties with respect to the subject matter hereof and supersedes any and all understandings, any other agreements, allotment letter, correspondences, arrangements whether written or oral, if any, between the Parties in regard to the said apartment/plot/building, as the case may be.

## **22. Right to Amend**

This Agreement may only be amended through written consent of the Parties.

## **23. Provisions of this Agreement Applicable on Allottee/Subsequent Allottees**

It is clearly understood and so agreed by and between the Parties hereto that all the provisions contained herein and the obligations arising hereunder in respect of the [Apartment/Plot] and the Project shall equally be applicable to and enforceable against and by any subsequent Allottees of the [Apartment/ Plot], in case of a transfer, as the said obligations go along with the [Apartment/ Plot] for all intents and purposes.

## **24. Waiver not a Limitation to Enforce**

### **24.1** The Promoter may, at its sole option and discretion, without prejudice to its rights as set out in this

Agreement, waive the breach by the Allottee in not making payments as per the Payment Plan [Annexure C] including waiving the payment of interest for delayed payment. It is made clear and so agreed by the Allottee that exercise of discretion by the Promoter in the case of one Allottee shall not be construed to be a precedent and /or binding on the Promoter to exercise such discretion in the case of other Allottees.

### **24.2** Failure on the part of the Parties to enforce at any time or for any period of time the provisions hereof shall not be construed to be a waiver of any provisions or of the right thereafter to enforce each and every provision.

## **25. Severability**

If any provision of this Agreement shall be determined to be void or unenforceable under the Act or the Rules and Regulations made thereunder or under other applicable laws, such provisions of the Agreement shall be deemed amended or deleted in so far as reasonably inconsistent with the purpose of this Agreement and to the extent necessary to conform to Act or the Rules or Regulations made thereunder or the applicable law, as the case may be, and the remaining provisions of this Agreement shall remain valid and enforceable as applicable at the time of execution of this Agreement.

## **26. Method of Calculation of Proportionate Share wherever referred to in the Agreement**

Wherever in this Agreement it is stipulated that the Allottee has to make any payment, in common with other Allottee(s) in Project, the same shall be the proportion which the carpet area of the [Apartment/ Plot] bears to the total carpet area of all the [Apartments/Plots] in the Project.

## **27. Further Assurances**

Both Parties agree that they shall execute, acknowledge and deliver to the other such instruments and take such other actions, in additions to the instruments and actions specifically provided for herein, as may be reasonably required in order to effectuate the provisions of this Agreement or of any transaction contemplated herein or to confirm or perfect any right to be created or transferred hereunder or pursuant to any such transaction.

## **28. Place of Execution**

The execution of this Agreement shall be complete only upon its execution by the Promoter through its authorized signatory at the Promoter's Office, or at some other place, which may be mutually agreed between the Promoter and the Allottee, in \_\_\_\_\_ after the Agreement is duly executed by the Allottee and the Promoter or simultaneously with the execution the said Agreement shall be registered at the office of the Sub-Registrar at \_\_\_\_\_

(specify the address of the Sub-Registrar). Hence this Agreement shall be deemed to have been executed at.

## 29. Notices

That all notices to be served on the Allottee and the Promoter as contemplated by this Agreement shall be deemed to have been duly served if sent to the Allottee or the Promoter by Registered Post at their respective addresses specified below:

\_\_\_\_\_ Name of Allottee

\_\_\_\_\_ (Allottee Address)

M/s \_\_\_\_\_ Promoter name

\_\_\_\_\_ (Promoter Address)

It shall be the duty of the Allottee and the Promoter to inform each other of any change in address subsequent to the execution of this Agreement in the above address by Registered Post failing which all communications and letters posted at the above address shall be deemed to have been received by the promoter or the Allottee, as the case may be.

## 30. Joint Allottees

That in case there are Joint Allottees all communications shall be sent by the Promoter to the Allottee whose name appears first and at the address given by him/her which shall for all intents and purposes to consider as properly served on all the Allottees.

## 31. Savings

Any application letter, allotment letter, agreement, or any other document signed by the allottee, in respect of the apartment, plot or building, as the case may be, prior to the execution and registration of this Agreement for Sale for such apartment, plot or building, as the case may be, shall not be construed to limit the rights and interests of the allottee under the Agreement for Sale or under the Act or the rules or the regulations made thereunder.

## 32. Governing Law

That the rights and obligations of the parties under or arising out of this Agreement shall be construed and enforced in accordance with the Act and the Rules and Regulations made thereunder including other applicable laws of India for the time being in force.

## 33. Dispute Resolution

All or any disputes arising out or touching upon or in relation to the terms and conditions of this Agreement, including the interpretation and validity of the terms thereof and the respective rights and obligations of the Parties, shall be settled amicably by mutual discussion, failing which the same shall be settled through the adjudicating officer appointed under the Act.

[Please insert any other terms and conditions as per the contractual understanding between the parties, however, please ensure that such additional terms and conditions are not in derogation of or inconsistent with the terms and conditions set out above or the Act and the Rules and Regulations made thereunder.]

IN WITNESS WHEREOF parties hereinabove named have set their respective hands and signed this Agreement for Sale at \_\_\_\_\_

(city/town name) in the presence of attesting witness, signing as such on the day first above written.

### Signed and Delivered by the within Named

1. Allottee: (including joint buyers)

Signature \_\_\_\_\_

Name \_\_\_\_\_

Address \_\_\_\_\_

2. Signature \_\_\_\_\_

Name \_\_\_\_\_

Address \_\_\_\_\_

Please affix  
photograph and  
sign across the  
photograph

**Signed and Delivered by the within Named**

Promoter:

1. Signature (Authorised Signatory) \_\_\_\_\_

Name \_\_\_\_\_

Address \_\_\_\_\_

At \_\_\_\_\_ on \_\_\_\_\_ in the presence of:

Please affix  
photograph and  
sign across the  
photograph

WITNESSES:

1. Signature \_\_\_\_\_

Name \_\_\_\_\_

Address \_\_\_\_\_

2. Signature \_\_\_\_\_

Name \_\_\_\_\_

Address \_\_\_\_\_

Please affix  
photograph and  
sign across the  
photograph

**SCHEDULE 'A'** — PLEASE INSERT DESCRIPTION OF THE [APARTMENT/PLOT] AND THE GARAGE/ COVERED PARKING (IF APPLICABLE) ALONG WITH BOUNDARIES IN ALL FOUR DIRECTIONS

**SCHEDULE 'B'** — FLOOR PLAN OF THE APARTMENT

**SCHEDULE 'C'** — PAYMENT PLAN

**SCHEDULE 'D'** — SPECIFICATIONS, AMENITIES, FACILITIES (WHICH ARE PART OF THE APARTMENT / PLOT)

**SCHEDULE 'E'** — SPECIFICATIONS, AMENITIES, FACILITIES (WHICH ARE PART OF THE PROJECT)

[The 'Schedules' to this Agreement for Sale shall be as agreed to between the Parties]

### LESSON ROUND-UP

- Parliament enacted the Real Estate (Regulation and Development) Act, 2016 which aims at protecting the rights and interests of consumers and promotion of uniformity and standardization of business practices and transactions in the real estate sector. It attempts to balance the interests of consumers and promoters by imposing certain responsibilities on both. It seeks to establish symmetry of information between the promoter and purchaser, transparency of contractual conditions, set minimum standards of accountability and a fast-track dispute resolution mechanism.
- Carpet area means the net usable floor area of an apartment, excluding the area covered by the external walls, areas under services shafts, exclusive balcony or verandah area and exclusive open terrace area, but includes the area covered by the internal partition walls of the apartment.
- Real estate project means the development of a building or a building consisting of apartments, or converting an existing building or a part thereof into apartments, or the development of land into plots or apartment, as the case may be, for the purpose of selling all or some of the said apartments or plots or building, as the case may be, and includes the common areas, the development works, all improvements and structures thereon, and all easement, rights and appurtenances belonging thereto.
- A promoter shall not advertise, market, book, sell or offer for sale, or invite persons to purchase in any manner any plot, apartment or building, as the case may be, in any real estate project or part of it, in any planning area, without registering the real estate project with the Real Estate Regulatory Authority established.
- The appropriate Government shall establish an Authority to be known as the Real Estate Regulatory Authority to exercise the powers conferred on it and to perform the functions assigned to it under the Act.

- The Central Advisory Council is required to advise the Central Government on matters relating to implementation of the Act, questions of policy, protection of consumer interest, foster growth and development of the real estate sector, and other matters as may be assigned to it by the Central Government.
- Real Estate Appellate Tribunal (REAT) is to be formed by appropriate government to ensure faster resolution of disputes. Parties aggrieved by the RERA order can appeal before REAT and REAT has to adjudicate such cases within 60 days. Civil Courts have been prevented from exercising jurisdiction on such matters.
- As per Section 56 of the Act, a Company Secretary holding certificate of practice can appear before Appellate Tribunal or a Regulatory Authority or Adjudicating Officer on behalf of applicant or appellant as the case may be.

### TEST YOUR SELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Who is the 'appropriate Government' as per the Act?
2. What is the difference between the term 'common area' and 'carpet area'?
3. What is the definition of 'real estate project'? Does the term 'project' connote a 'real estate project'?
4. What are the disclosures to be made on the website of the Regulatory Authority?
5. What are the rights and duties of the allottees under the Act?



## Lesson 18

# The Benami Transactions (Prohibition) Act, 1988

### ***Key Concepts One Should Know***

- Benami Property
- Benami Transaction
- Prohibition of Benami Transaction

### ***Learning Objectives***

#### **To understand:**

- Prohibition of Benami Transaction
- Adjudication of Benami Property
- Securities held by a Depository
- Confiscation of Benami Property
- Punishment

### ***Regulatory Framework***

- The Benami Transactions (Prohibition) Act, 1988
- Depositories Act, 1996

### ***Lesson Outline***

- Benami Property
- Benami Transaction
- Prohibition of Benami Transaction
- Authority & Adjudication of Benami Property
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

The Benami Transactions (Prohibition) Act, 1988 was enacted to prohibit benami transactions and the right to recover property held benami. The said Act, inter alia, provides that – (a) all the properties held benami shall be subject to acquisition by such authority in such manner and after following such procedure as may be prescribed; (b) no amount shall be payable for the acquisition of any property held benami; (c) the purchase of property by any person in the name of his wife or unmarried daughter for their benefit would not be benami transaction; (d) the securities held by a depository as registered owner under the provisions of the Depositories Act, 1996 or participant as an agent of a depository would not be benami transactions.

During the administration of the Benami Transactions (Prohibition) Act, 1988, it was found that the provisions of the aforesaid Act are inadequate to deal with benami transactions as the Act does not – (i) contain any specific provision for vesting of confiscated property with Central Government; (ii) have any provision for an appellate mechanism against an action taken by the authorities under the Act, while barring the jurisdiction of a civil court; confer the powers of the civil court upon the authorities for its implementation; and (iv) provide for adequate enabling rule making powers.

In view of the circumstances stated above, comprehensive amendments to the Benami Transactions (Prohibition) Act, 1988 has become necessary in order to prohibit holding property in benami and restrict right to recover or transfer property held benami and also to provide a mechanism and procedure for confiscation of property held benami. It is, therefore, felt necessary to bring comprehensive amendments to the Benami Transactions (Prohibition) Act, 1988 to deal with benami transactions.

With a view to providing effective regime for prohibition of benami transactions, the Benami Transactions (Prohibition) Act, 1988 was amended through the Benami Transactions (Prohibition) Amended Act, 2016. The amended law empowers the specified authorities to provisionally attach benami properties which can eventually be confiscated. Besides, if a person is found guilty of offence of benami transaction by the competent court, he shall be punishable with rigorous imprisonment for a term not less than one year but which may extend to 7 years and shall also be liable to fine which may extend to 25% of the fair market value of the property.

The legislation is also intended to effectively prohibit benami transactions and consequently prevent circumvention of law through unfair practices. It empowers the Government to confiscate benami property by following due procedure. It therefore promotes equity across all citizens. However, those who declare their benami properties under income declaration scheme will get immunity under the Benami Act.

The Benami Transactions (Prohibition) Amendment Act, 2016 received the assent of the President on the 10th August, 2016 and came into effect from 1st November, 2016.

### ***The Salient Features of the Benami Transactions (Prohibition) Act, 1988 are as under:***

- It defines a benami transaction and benami property and also provides for exclusions and transactions which shall not be construed benami
- It provides the consequences of entering into a prohibited benami transactions
- It lays down the procedure for determination and related penal consequences in the case of a prohibited benami transaction
- It also provides that the powers of civil court shall be available to authorities under the said Act
- Miscellaneous Provisions have been provided for service of notice, protection of action taken in good faith, etc.
- Central Government empowers to make rules for the implementation of the provisions of the Act
- It enables the Central Government in consultation with the Chief Justice of the High Court to designate one or more Courts of Session as Special Court or Special Courts for the purpose of the Act
- It provides penalty for entering into benami transactions and for furnishing any false documents in any proceeding under the Act
- It provides for transfer of any suit or proceeding in respect of a benami transaction pending in any court (other than High Court) or Tribunal or before any authority to the Appellate Tribunal

## IMPORTANT DEFINITIONS

### “Attachment”

Attachment means the prohibition of transfer, conversion, disposition or movement of property, by an order issued under the Act. [Section 2(5)]

### “Benami Property”

Benami Property means any property which is the subject matter of a benami transaction and also includes the proceeds from such property. [Section 2(8)]

### “Benami Transaction”

As per Section 2 (9) of the benami transaction means-

- (A) a transaction or an arrangement—
  - (a) where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and
  - (b) the property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration, except when the property is held by—
    - (i) a Karta, or a member of a Hindu undivided family, as the case may be, and the property is held for his benefit or benefit of other members in the family and the consideration for such property has been provided or paid out of the known sources of the Hindu undivided family;
    - (ii) a person standing in a fiduciary capacity for the benefit of another person towards whom he stands in such capacity and includes a trustee, executor, partner, director of a company, a depository or a participant as an agent of a depository under the Depositories Act, 1996 and any other person as may be notified by the Central Government for this purpose;
    - (iii) any person being an individual in the name of his spouse or in the name of any child of such individual and the consideration for such property has been provided or paid out of the known sources of the individual;
    - (iv) any person in the name of his brother or sister or lineal ascendant or descendant, where the names of brother or sister or lineal ascendant or descendant and the individual appear as joint-owners in any document, and the consideration for such property has been provided or paid out of the known sources of the individual; or
- (B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name; or
- (C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies knowledge of, such ownership;
- (D) a transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious;

*Explanation.*—For the removal of doubts, it is hereby declared that benami transaction shall not include any transaction involving the allowing of possession of any property to be taken or retained in part performance of a contract referred to in section 53A of the Transfer of Property Act, 1882, if, under any law for the time being in force,—

- (i) consideration for such property has been provided by the person to whom possession of property has been allowed but the person who has granted possession thereof continues to hold ownership of such property;
- (ii) stamp duty on such transaction or arrangement has been paid; and
- (iii) the contract has been registered.

**“Benamidar”**

Benamidar means a person or a fictitious person, as the case may be, in whose name the benami property is transferred or held and includes a person who lends his name.[Section 2(10)]

**“Beneficial Owner”**

“Beneficial Owner” means a person, whether his identity is known or not, for whose benefit the benami property is held by a benamidar.[Section 2(10)]

**“Fair Market Value”**

Fair market value in relation to a property, means— (i) the price that the property would ordinarily fetch on sale in the open market on the date of the transaction; and (ii) where the price referred to in sub-clause (i) is not ascertainable, such price as may be determined in accordance with such manner as may be prescribed. [Section 2(16)]

**“Firm”**

Firm shall have the same meaning as assigned to it in section 4 of the Indian Partnership Act, 1932 and shall include a limited liability partnership as defined in the Limited Liability Partnership Act, 2008.[Section 2(17)]

**“Partner”**

Partner shall have the same meaning as assigned to it in section 4 of the Indian Partnership Act, 1932, and shall include,—

- (a) any person who, being a minor, has been admitted to the benefits of partnership; and
- (b) a partner of a limited liability partnership formed and registered under the Limited Liability Partnership Act, 2008.[Section 2(22)]

**“Partnership”**

Partnership shall have the same meaning as assigned to it in section 4 of the Indian Partnership Act, 1932, and shall include a limited liability partnership formed and registered under the Limited Liability Partnership Act, 2008. [Section 2(23)]

**“Person”**

Person shall include—

- (i) an individual;
- (ii) a Hindu undivided family;
- (iii) a company;
- (iv) a firm;
- (v) an association of persons or a body of individuals, whether incorporated or not;
- (vi) every artificial juridical person, not falling under sub-clauses (i) to (v).[Section 2(23)]

**“Property”**

Property means assets of any kind, whether movable or immovable, tangible or intangible, corporeal or incorporeal and includes any right or interest or legal documents or instruments evidencing title to or interest in the property and where the property is capable of conversion into some other form, then the property in the converted form and also includes the proceeds from the property. [Section 2(26)]

**“Transfer”**

Transfer includes sale, purchase or any other form of transfer of right, title, possession or lien. [Section 2(26)]

## Prohibition of benami transactions-

As per Section 3 of the Act, no person shall enter into any benami transaction. Whoever enters into any benami transaction shall be punishable with imprisonment for a term which may extend to three years or with fine or with both.

Where any person enters into any benami transaction on and after the date of commencement of the Benami Transactions (Prohibition) Amendment Act, 2016, shall be punishable in accordance with the provisions contained in Chapter VII.

Chapter VII deals with offences and prosecution. It provides that if a person is found guilty of offence of benami transaction by the competent court, he shall be punishable with rigorous imprisonment for a term not less than one year but which may extend to 7 years and shall also be liable to fine which may extend to 25% of the fair market value of the property.

## Prohibition of the right to recover property held benami

Section 4(1) provides that no suit, claim or action to enforce any right in respect of any property held benami against the person in whose name the property is held or against any other person shall lie by or on behalf of a person claiming to be the real owner of such property.

Further, Section 4(2) provides that no defense based on any right in respect of any property held benami, whether against the person in whose name the property is held or against any other person, shall be allowed in any suit, claim or action by or on behalf of a person claiming to be the real owner of such property.

## Property held benami liable to confiscation

As per section 5 of the Act any property, which is subject matter of benami transaction, shall be liable to be confiscated by the Central Government.

## Prohibition on re-transfer of property by benamidar

Section 6 provides that a person, being a benamidar shall not re-transfer the benami property held by him to the beneficial owner or any other person acting on his behalf.

Where any property is re-transferred in contravention of the above the transaction of such property shall be deemed to be null and void.

Above provisions shall not apply to a transfer made in accordance with the provisions of section 190 of the Finance Act, 2016.

## Notice and attachment of property involved in benami transaction

Section 24 relates to notice and attachment of property involved in benami transaction. Sub-section (1) of this section provides that where the Initiating Officer, on the basis of material in his possession, has reason to believe that any person is a benamidar in respect of a property, he may, after recording reasons in writing, issue a notice to such person to show cause within such time as may be specified in the notice why the property should not be treated as benami property. Sub-section (2) of this section provides that a copy of the notice may also be served upon such other person who is a beneficial owner.

Sub-section (3) of this section provides that where the Initiating Officer is of the opinion that the person in possession of the property held benami may alienate such property during the period specified in the notice, he may, with the previous approval of the Approving Authority, by order in writing, attach provisionally such property in the manner as may be prescribed, for a period not exceeding ninety days from the date of issue of notice under sub-section (1).

Sub-section (4) of this section provides that the Initiating Officer, after making such inquiries and calling for such reports or evidence as he deems fit and taking into account all relevant materials, shall, within a period of ninety days from the date of issue of notice under sub-section (1), -

- (a) where the provisional attachment has been made under sub-section (3), -
  - (i) pass an order continuing the provisional attachment of the property with the prior approval of the Approving Authority, till the passing of the order by the Adjudicating Authority under sub-section (3) of section 26; or (ii) revoke the provisional attachment of the property with the prior approval of the Approving Authority;
- (b) where provisional attachment has not been made under sub-section (3), -
  - (i) pass an order provisionally attaching the property with the prior approval of the Approving Authority, till the passing of the order made by the Adjudicating Authority under sub-clause (3) of section 26; or
  - (ii) decide not to attach the property as specified in the notice, with the prior approval of the Approving Authority.

Sub-section (5) of this section provides that where the Initiating Officer passes an order continuing the provisional attachment of the property under sub-clause (i) of clause (a) of sub-section (4) or passes an order provisionally attaching the property under sub-clause (i) of clause (b) of that sub-section, he shall, within fifteen days from the date of the attachment, draw up a statement of the case and refer it to the Adjudicating Authority.

It may be noted that Initiating Officer means an Assistant Commissioner or a Deputy Commissioner as defined in clauses (9A) and (19A) respectively of section 2 of the Income-tax Act, 1961.

### **Manner of service of notice**

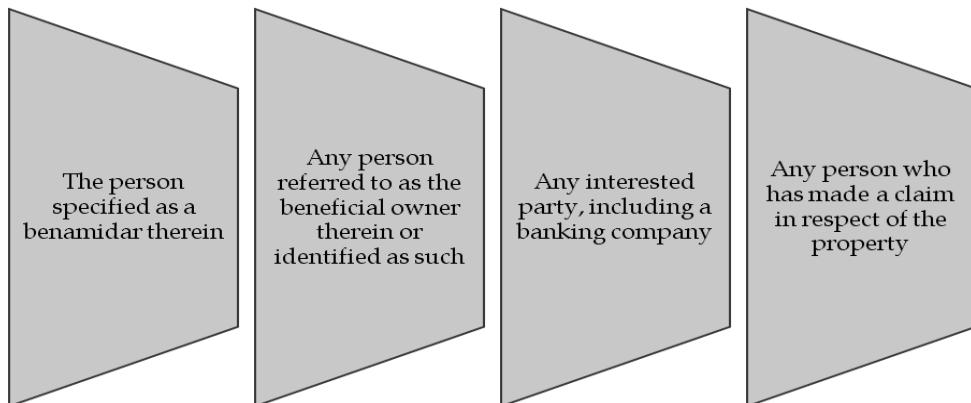
Section 25 deals with the manner of service of notice. Sub-section (1) of this section provides that a notice under sub-clause (1) of section 24 may be served on the person named therein either by post or as if it were a summons issued by a Court under the Code of Civil Procedure, 1908.

Sub-section (2) of this section provides that any notice referred to above may be addressed---

- (i) in case of an individual, to such individual ;
- (ii) in the case of a firm, to the managing partner or the manager of the firm;
- (iii) in the case of a Hindu undivided family, to karta or any member of such family;
- (iv) in the case of a company, to the principal officer thereof;
- (v) in the case of any other association or body of individuals, to the principal officer or any member thereof;
- (vi) in the case of any other person (not being an individual), to the person who manages or controls his affairs.

### **Adjudication of benami property**

Section 26 relates to adjudication of benami property. Sub-section (1) of this section provides that on receipt of a reference under sub-section (5) of section 24, the Adjudicating Authority shall issue notice, to furnish such documents, particulars or evidence as is considered necessary on a date to be specified therein, on the following persons:-



However, the Adjudicating Authority shall issue notice within a period of thirty days from the date on which a reference has been received. Further, the notice shall provide a period of time of not less than thirty days to the person to whom such notice is issued to furnish the information sought.

Sub-section (2) of this section provides that where such property is held jointly by more than one person, the Adjudicating Authority shall make endeavours to serve notice to all persons holding such property. However, where the notice is served on one of the aforesaid persons the service of notice shall not be invalid on the ground that the said notice was not served to all the persons holding the property.

Sub-section (3) of this section provides that the Adjudicating Authority shall, after considering the reply, if any, to the notice issued under sub-section(1);making or causing to be made such inquiries and calling for such reports or evidence as it deems fit; and taking into account all relevant materials, provide an opportunity of being heard to the person specified as a benamidar therein, the Initiating Officer, and any other person who claims to be the owner of such property. Thereafter, the Adjudicating Authority shall pass an order holding the property not to be a benami property and revoking the attachment order; or holding the property to be a benami property and confirming the attachment order in all other cases.

Sub-section (4) of this section provides that where the Adjudicating Authority is satisfied that some part of the properties in respect of which reference has been made to him is benami property, but is not able to specifically identify such part, he shall record a finding to the best of his judgment as to which part or properties is held benami.

Sub-section (5) of this section provides that where in the course of proceedings before it, the Adjudicating Authority has reason to believe that a property, other than a property referred to him by the Initiating Officer is benami property, it shall provisionally attach the property and the property shall be deemed to be a property referred to it on the date of receipt of the reference under sub-section (5) of section 24.

Sub-section (6) of this section provides that the Adjudicating Authority may, at any stage of the proceedings, either on the application of any party, or suo moto, strike out the name of any party improperly joined or add the name of any person whose presence before the Adjudicating Authority may be necessary to enable it to adjudicate upon and settle all the questions involved in the reference.

Sub-section (7) of this section provides that no order under sub-section (3) shall be passed after the expiry of one year from the end of the month in which the reference under section 24 was received.

As per section 7 of the Act, the Central Government shall, by notification, appoint one or more Adjudicating Authorities to exercise jurisdiction, powers and authority conferred by or under this Act. An Adjudicating Authority shall consist of a Chairperson and at least two other Members.

### Confiscation and vesting of benami property

Section 27 deals with confiscation and vesting of benami property. Sub-section (1) of this section provides that where an order is passed in respect of any property under sub-section (3) of section 26 holding such property to be a benami property, the Adjudicating Authority shall, after giving an opportunity of being heard to the person concerned, make an order confiscating the property held to be a benami property. However, where an appeal has

been filed against the order of the Adjudicating Authority, the confiscation of property shall be made subject to the order passed by the Appellate Tribunal under section 46. Further, confiscation of the property shall be made in accordance with such procedure as may be prescribed.

Sub-section (2) of this section provides that the above shall not apply to a property held or acquired by a person from the benamidar for adequate consideration, prior to the issue of notice under sub-section (1) of section 24 without his having knowledge of the benami transaction.

Sub-section (3) of this section provides that where an order of confiscation has been made, all the rights and title in such property shall vest absolutely in the Central Government free of all encumbrances and no compensation shall be payable in respect of such confiscation.

Sub-section (4) of this section provides that any right of any third person created in such property with a view to defeat the purposes of this Act shall be null and void.

Sub-section (5) of this section provides that where no order of confiscation is made upon the proceedings under this Act attaining finality, no claim shall lie against the Government.

### Management of properties confiscated

Section 28 relates to management of properties confiscated under this Act. Sub-section (1) of this section provides that the Administrator shall have the power to receive and manage the property, in relation to which an order of confiscation under sub-section (1) of section 27 has been made, in such manner and subject to such conditions, as may be prescribed.

Sub-section (2) of this section provides that the Central Government may, by order published in the Official Gazette, notify as many of its officers as it thinks fit, to perform the functions of Administrators.

Sub-section (3) of this section provides that the Administrator shall also take such measures, as the Central Government may direct, to dispose of the property which is vested in the Central Government under sub-section (3) of section 27 in such manner and subject to such conditions as may be prescribed.

### Possession of the property

Section 29 relates to possession of the property. Sub-section (1) of this section provides that where an order of confiscation in respect of a property under subsection (1) of section 27 has been made, the Administrator shall proceed to take the possession of such property.

Sub-section (2) of this section provides that the Administrator shall, -

- (a) by notice in writing, order within seven days of the date of the service of notice any person, who may be in possession of the benami property, to surrender or deliver possession thereof to the Administrator or any other person duly authorised in writing by him in this behalf;
- (b) in the event of non-compliance of the order referred to in clause (a), or if in his opinion, taking over of immediate possession is warranted, for the purpose of forcibly taking over possession, requisition the service of any police officer to assist him and it shall be the duty such officer to comply with the requisition.

It may be noted that "Administrator" means an Income-tax Officer as defined in clause (25) of section 2 of the Income-tax Act, 1961

### Appellate Tribunal

Chapter V deals with the provisions relating to the Appellate Tribunal. Section 30 deals with establishment of Appellate Tribunal. The said section seeks to provide that the Central Government shall, by notification, establish an Appellate Tribunal to hear appeals against the orders of the Adjudicating Authority and the authorities under this Act.

Section 40 lays down the procedure and powers of Appellate Tribunal. Subsection (1) of this section provides that the Appellate Tribunal shall not be bound by the procedure laid down by the Code of Civil Procedure, 1908, but shall be guided by the principles of natural justice and, subject to the other provisions of this Act, the Appellate Tribunal shall have powers to regulate its own procedure.

### Appeal to High Court

Section 49 relates to appeal to High Court. Sub-section (1) of this section provides that any party aggrieved by any decision or order of the Appellate Tribunal may file an appeal to the High Court within sixty days from the date of communication of the decision or order of the Appellate Tribunal to him on any question of law arising out of such order.

Sub-section (2) of this section provides that the High Court may entertain any appeal after the said period of sixty days, if it is satisfied that the appellant was prevented by sufficient cause from filing the appeal within the period specified in sub-section (1).

Sub-section (3) of this section provides that where the High Court is satisfied that a substantial question of law is involved in any case, it shall formulate that question.

Sub-section (4) of this section provides that the appeal shall be heard only on the question so formulated, and the respondents shall, at the hearing of the appeal, be allowed to argue that the case does not involve such question.

Sub-section (5) of this section provides that nothing in this sub-section shall be deemed to take away or abridge the power of the court to hear, for reasons to be recorded, the appeal on any other substantial question of law not formulated by it, if it is satisfied that the case involves such question.

Sub-section (6) of this section provides that the High Court shall decide the question of law so formulated and deliver such judgment thereon containing the grounds on which such decision is founded and may award such cost as it deems fit.

Sub-section (7) of this section provides that the High Court may determine any issue which — (a) has not been determined by the Appellate Tribunal; or (b) has been wrongly determined by the Appellate Tribunal, by reason of a decision on such question of law as is referred to in sub-section (1).

Sub-section (8) of this section provides that save as otherwise provided in this Act, the provisions of the Code of Civil Procedure, 1908, relating to appeals to the High Court shall, as far as may be, apply in the case of appeals under this section.

### Special Courts

Section 50 relates to Special Courts. Sub-section (1) of this section provides that the Central Government, in consultation with the Chief Justice of the High Court, shall for trial of an offence punishable under this Act, by notification, designate one or more Courts of Session as Special Court or Special Courts for such area or areas or for such case or class or group of cases as may be specified in the notification.

Sub-section (2) of this section provides that while trying an offence under this Act, a Special Court shall also try an offence other than an offence referred to in sub-section (1), with which the accused may, under the Code of Criminal Procedure, 1973, be charged at the same trial.

Sub-section (3) of this section provides that the Special Court shall not take cognizance of any offence punishable under this Act except upon a complaint in writing made by - (i) the authority; or (ii) any officer of the Central Government or State Government authorised in writing by that Government by a general or special order made in this behalf.

Sub-section (4) of this section provides that every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made by the Special Court to conclude the trial within six months from the date of filing of the complaint.

## Offences and Prosecution

Chapter VII deals with the provisions relating to offences and prosecution. Section 53 relates to penalty for benami transaction. Sub-section (1) of this section provides that where any person enters into a benami transaction in order to defeat the provisions of any law or to avoid payment of statutory dues or to avoid payment to creditors, the beneficial owner, benamidar and any other person who abets or induces any person to enter into such benami transaction, shall be guilty of the offence of benami transaction.

Sub-section (2) of this section provides that whoever is found guilty of the offence of benami transaction referred to above shall be punishable with rigorous imprisonment for a term which shall not be less than one year, but which may extend to seven years and shall also be liable to fine which may extend to twenty-five per cent. of the fair market value of the property.

Section 54 relates to penalty for false information. This section provides that any person who is required to furnish information under this Act knowingly gives false information to any authority or furnishes any false document in any proceeding under this Act, shall be punishable with rigorous imprisonment for a term which shall not be less than six months but which may extend to five years and shall also be liable to fine which may extend to ten per cent. of the fair market value of the property.

Section 55 relates to previous sanction. This section provides that no prosecution shall be instituted against any person in respect of any offence under sections 3,53 or section 54 without the previous sanction of the Board.

## Offences by Companies

Section 62 relates to consequences in case of offences by companies. Subsection (1) of this section provides that where a person committing a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder is a company, every person who, at the time the contravention was committed, was in charge of, and was responsible to, the company, for the conduct of the business of the company as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

Sub-section (2) of this section provides that nothing contained in subsection (1) of this section shall render any person liable to punishment, if he proves that the contravention took place without his knowledge.

Sub-section (3) of this section provides that notwithstanding anything contained in sub-section (1), where a contravention of any of the provisions of this Act or of any rule, direction or order made thereunder has been committed by a company and it is proved that the contravention has taken place with the consent or connivance of, or is attributable to any neglect on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.

It may be noted that for the purpose of section 62, a "Company" means a body corporate, and includes

- (i) A firm; and
  - (ii) An association of persons or a body of individuals whether incorporated or not; and
- "Director", in relation to—
- (i) A firm, means a partner in the firm;
  - (ii) Any association of persons or a body of individuals, means any member controlling the affairs thereof.

**LESSON ROUND-UP**

- The Benami Transactions (Prohibition) Act, 1988 prohibits benami transactions and consequently prevent circumvention of law through unfair practices. It empowers the Government to confiscate benami property by following due procedure. It therefore promotes equity across all citizens. However, those who declare their benami properties under income declaration scheme will get immunity under the Benami Act.
- The Benami Transactions (Prohibition) Amendment Act, 2016 received the assent of the President on the 10th August, 2016 and came into effect from 1st November, 2016.
- Where any person enters into any benami transaction on and after the date of commencement of the Benami Transactions (Prohibition) Amendment Act, 2016, shall be punishable in accordance with the provisions contained in Chapter VII.
- Any property, which is subject matter of benami transaction, shall be liable to be confiscated by the Central Government.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. State the Salient Features of the Benami Transactions (Prohibition) Act, 1988
2. What is a Benami Transaction?
3. Discuss the attachment of property involved in benami transaction.
4. What are the penalties for Benami Property?
5. Write short notes on: (i) Benamidar (ii) Beneficial Owner.



## Lesson 19

# Prevention of Money Laundering

### ***Key Concepts One Should Know***

- Placement
- Layering
- Integration
- Money Laundering
- Reporting Entity

### ***Learning Objectives***

#### **To understand:**

- Problem and Adverse Effect of Money Laundering
- Methods of Money Laundering
- Offence of Money Laundering
- Attachment, Adjudication and Confiscation
- General Assembly of the United Nations to Prevent Money Laundering

### ***Regulatory Framework***

- The Prevention of Money-laundering Act, 2002

### ***Lesson Outline***

- Concept of Money Laundering
- Money Laundering Process
- Impact of Money Laundering on Economic Development
- Global initiatives for prevention of Money Laundering
- FAFT Recommendation
- Overview of Prevention of Money Laundering Act, 2002
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- Retention of Property
- Retention of Record
- Appellate Tribunal
- Special Court
- KYC Guidelines
- KYC Policy
- Power of Central Government
- Agreement with Foreign Countries
- Attachment of Property
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

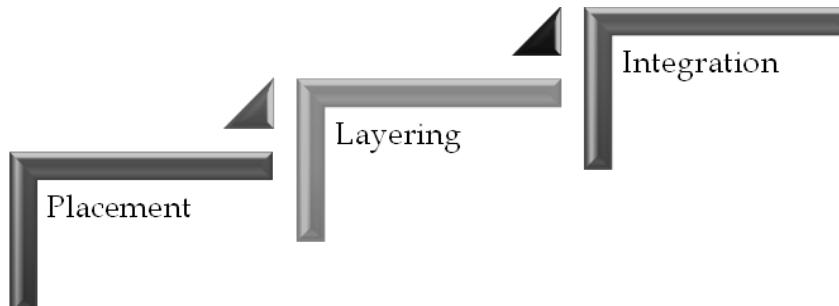
Money laundering is the processing of criminal proceeds to disguise its illegal origin. Terrorism, illegal arms sales, financial crimes, smuggling, and the activities of organised crime, including drug trafficking and prostitution rings etc., generate huge sums. Embezzlement, insider trading, bribery and computer fraud also produce large profits and create an incentive to legitimise the ill-gotten gains through money laundering. When a criminal activity generates substantial profits, the individual or group involved in such activities route the funds to safe heavens by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention.

Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generates it. In essence, the laundering enables criminal activity to continue.

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## Process of Money Laundering

The process of money laundering can be classified into three stages, namely, placement, layering and integration.



In the initial or placement stage of money laundering, the launderer introduces his illegal profits into the financial system, by breaking up large amounts of cash into less conspicuous smaller sums that are then deposited directly into a bank account, or by purchasing a series of monetary instruments that are later collected and deposited into accounts at another location.

After the fund enter into the financial system, the layering takes place. In this stage, the launderer engages in a series of conversions or movements of the funds to distance them from their source. The funds might be channeled through the purchase and sale of investment instruments, or the launderer might simply wire the funds through a series of accounts at various banks across the globe.

After successful processing of criminal profits through the first two phases of the money laundering process, the launderer moves them to integration. In this stage the funds re-enter the legitimate economy. The launderer might choose to invest the funds into real estate, luxury assets, or business ventures.

## Impact of Money Laundering on Development

Economies with growing or developing financial centers, but inadequate controls are particularly vulnerable to money laundering, as against the established financial center countries, which implement comprehensive anti-money laundering regimes. The gaps in a national anti-money laundering protecting system are exploited by launderers, who tend to move their networks to countries and financial systems with weak or ineffective countermeasures. As with the damaged integrity of an individual financial institution, there is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organised crime.

In times of decelerating growth, an infusion of hard currency can bolster a country's foreign reserves; ease the hardship associated with budget tightening policies and moderate foreign indebtedness. While these are short-term benefits associated with an inflow of criminal monies, the long-term effects are mostly negative. One difference between official borrowing and laundered funds is that the former can be controlled by Government, whereas the funds owned by criminals escape the governments ability to control and regulate the economy.

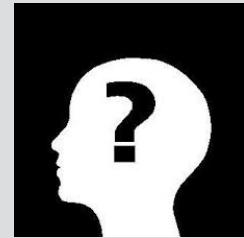
The possible social, economic and political effects of money laundering, if left unchecked or dealt with ineffectively, are serious. Through the process of money laundering, organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments. Thus, the economic and political influence of criminal organisations can weaken the social fabric, ethical standards and ultimately the democratic institutions of society.

### ***What is the connection of money laundering with society at large?***

*The possible social and political costs of money laundering, if left unchecked or dealt with ineffectively, are serious. Organised crime can infiltrate financial institutions, acquire control of large sectors of the economy through investment, or offer bribes to public officials and indeed governments.*

*The economic and political influence of criminal organisations can weaken the social fabric, collective ethical standards, and ultimately the democratic institutions of society.*

*In countries transitioning to democratic systems, this criminal influence can undermine the transition. Most fundamentally, money laundering is inextricably linked to the underlying criminal activity that generated it. Laundering enables criminal activity to continue.*



## **Prevention of Money Laundering – Global Initiatives**

Since money laundering is an international phenomenon, transnational co-operation is of critical importance in the fight against this menace. A number of initiatives have been taken to deal with the problem at international level. In this context, the United Nations or the Bank for International Settlements, took some initiatives in 1980s to address the problem of money laundering. However, with the creation of the Financial Action Task Force (FATF) in 1989, regional groupings, such as the European Union, Council of Europe, and organisation of American States also established anti- money laundering standards for their member countries.

The major international agreements addressing money laundering include the United Nations Convention against Illicit Trafficking in Drugs and Psychotropic Substances (the Vienna Convention) and Council of Europe Convention on Laundering, Search, Seizure and Confiscation of the Proceeds of Crime. The role of financial institutions in preventing and detecting money laundering has also been the subject of pronouncements by the Basle Committee on Banking Regulation Supervisory Practices, the European Union and the International Organization of Securities Commissions.

### **The Vienna Convention**

The first major initiative in the prevention of money laundering was the United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances in December 1988 (popularly known as Vienna Convention). This convention laid the groundwork for efforts to combat money laundering by obliging the member states to criminalize the laundering of money from drug trafficking and confiscation of proceeds derived from such offence. It promotes international cooperation in investigations and makes extradition between member states applicable to money laundering. The convention also establishes the principle that domestic bank secrecy provisions should not interfere with international criminal investigations.

### **Council of Europe Convention**

The Council of Europe Convention on Laundering, Search, Seizure and Confiscation of Proceeds of Crime, 1990 establishes a common policy on money laundering. It sets out a common definition of money laundering and common measures for dealing with it. The Convention lays down the principles for international cooperation among the member states, which may also include states outside the Council of Europe. This convention came into force in September 1993. One of the purposes of the convention is to facilitate international cooperation as regards investigative assistance, search, seizure and confiscation of the proceeds of all types of criminality, particularly serious crimes, such as, drug offences, arms dealing, terrorist offences etc. and other offences which generate large profits.

## European Union Money Laundering Directive

In response to the new opportunities for money laundering opened up by the liberalization of capital movements and cross-border financial services in the European Union, the Council of the European Communities in June, 1991 issued a directive on the Prevention of Use of the Financial System for the Purpose of Money Laundering. The directive requires member states to outlaw money laundering. The member states have been put under obligation to require financial institutions to establish and maintain internal systems to prevent laundering, to obtain the identification of customers with whom they enter into transaction of more than a particular amount and to keep proper records for at least five years. The financial institutions are also required to report suspicious transactions and ensure that such reporting does not result in liability for the institution or its employees.

## Basle Committee's Statement of Principles

In December 1988 the Basle Committee on Banking Regulation Supervisory Practices issued a statement of principles to be complied by the international banks of member states. These principles include identifying customers, avoiding suspicious transactions, and cooperating with law enforcement agencies. The statement aims at encouraging the banking sector to adopt common position in order to ensure that banks are not used to hide or launder funds acquired through criminal activities.

The International Organization of Securities Commissions (IOSCO) adopted, in October 1992, a resolution encouraging its members to take necessary steps to combat money laundering in securities and futures markets.

## The Financial Action Task Force (FATF)

The Financial Action Task Force (FATF) is an inter-governmental body established in 1989 by the Ministers of its Member jurisdictions. The objectives of the FATF are to set standards and promote effective implementation of legal, regulatory and operational measures for combating money laundering, terrorist financing and other related threats to the integrity of the international financial system. The FATF is therefore a "policy-making body" which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.

The FATF has developed a series of Recommendations that are recognised as the international standard for combating of money laundering and the financing of terrorism and proliferation of weapons of mass destruction. They form the basis for a co-ordinated response to these threats to the integrity of the financial system and help ensure a level playing field. First issued in 1990, the FATF Recommendations were revised in 1996, 2001, 2003 and in 2012 to ensure that they remain up to date and relevant, and they are intended to be of universal application.

The FATF monitors the progress of its members in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally. In collaboration with other international stakeholders, the FATF works to identify national-level vulnerabilities with the aim of protecting the international financial system from misuse.

### History of the FATF

In response to mounting concern over money laundering, the Financial Action Task Force on Money Laundering (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognising the threat posed to the banking system and to financial institutions, the G-7 Heads of State or Government and President of the European Commission convened the Task Force from the G-7 member States, the European Commission and eight other countries.

## FATF Recommendations

The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, the FATF issued a report containing a set of *Forty Recommendations*, which were intended to provide a comprehensive plan of action needed to fight against money laundering.

In 2001, the development of standards in the fight against terrorist financing was added to the mission of the FATF. In October 2001 the FATF issued the Eight Special Recommendations to deal with the issue of terrorist financing. The continued evolution of money laundering techniques led the FATF to revise the FATF standards comprehensively in June 2003. In October 2004 the FATF published a Ninth Special Recommendations, further strengthening the agreed international standards for combating money laundering and terrorist financing - the *40+9 Recommendations*.

The various broad heads of recommendations include declaration of laundering of monies carried through serious crimes a criminal offence, to work out modalities of disclosure by financial institutions regarding reportable transactions, confiscation of proceeds of crime, declaring money laundering to be an extraditable offence, promoting international co-operation in investigation of money laundering etc.

In February 2012, the FATF completed a thorough review of its standards and published the revised FATF Recommendations. This revision is intended to strengthen global safeguards and further protect the integrity of the financial system by providing governments with stronger tools to take action against financial crime. They have been expanded to deal with new threats such as the financing of proliferation of weapons of mass destruction, and to be clearer on transparency and tougher on corruption. The 9 Special Recommendations on terrorist financing have been fully integrated with the measures against money laundering. This has resulted in a stronger and clearer set of standards.

### United Nations Global Programme Against Money Laundering

Office of the Drug Control and Crime Prevention implement this programme against Money Laundering with a view to increase the effectiveness of international action against money laundering through comprehensive technical cooperation services offered to Governments. The programme encompasses following three areas of activities, providing various means to states and institutions in their efforts to effectively combat money laundering:

- (i) Technical cooperation is the main task of the Programme. It encompasses activities of creating awareness, institution building and training.
- (ii) The research and analysis aims at offering States Key Information to better understand the phenomenon of money laundering and to enable the international community to devise more efficient and effective countermeasure strategies.
- (iii) The commitment to support the establishment of financial investigation services for raising the overall effectiveness of law enforcement measures.

The implementation of the Global Programme against Money Laundering is carried out in the spirit of cooperation with other international, regional and national organizations and institutions.

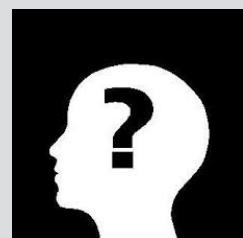
#### ***What influence does money laundering have on economic development?***

*Launderers are continuously looking for new routes for laundering their funds. Economies with growing or developing financial centres, but inadequate controls are particularly vulnerable as established financial centre countries implement comprehensive anti-money laundering regimes.*

*Differences between national anti-money laundering systems will be exploited by launderers, who tend to move their networks to countries and financial systems with weak or ineffective countermeasures.*

*Some might argue that developing economies cannot afford to be too selective about the sources of capital they attract. But postponing action is dangerous. The more it is deferred, the more entrenched organised crime can become.*

*As with the damaged integrity of an individual financial institution, there is a damping effect on foreign direct investment when a country's commercial and financial sectors are perceived to be subject to the control and influence of organised crime. Fighting money laundering and terrorist financing is therefore a part of creating a business friendly environment which is a precondition for lasting economic development.*



## Prevention of Money Laundering – Indian Initiatives

In view of an urgent need for the enactment of a comprehensive legislation for preventing money-laundering and connected activities, confiscation of proceeds of crime, setting up of agencies and mechanisms for coordinating measures for combating money laundering etc., the Prevention of Money-Laundering Bill 1998 was introduced in the Parliament on the 4th August, 1998. The Bill was referred to the Standing Committee on Finance, which presented its report on the 4th March, 1999 to Lok Sabha. After incorporating the recommendations of the Standing Committee, the Government introduced the Prevention of Money Laundering Bill 1999 in the Parliament on October 29, 1999. The Bill received the assent of the President and became Prevention of Money Laundering Act, 2002 on 17th January 2003. The Act has come in force with effect from July 1, 2005.

## PREVENTION OF MONEY LAUNDERING ACT, 2002

### Scheme of the Act

The Prevention of Money Laundering Act, 2002 consists of ten chapters containing 75 sections and one Schedule. Chapter I containing section 1 and 2 deals with short title, extent and commencement and definitions. Chapter II containing sections 3 and 4 provides for offences and punishment for money laundering. Chapter III (Section 5-11) provides for attachment, adjudication and confiscation and Chapter IV (Sections 12-15) deals with obligations of banking companies, financial institutions and intermediaries. Chapter V (Sections 16-24) relates to Summons, Searches and Seizures etc.

The Act provides for establishment of Appellate Tribunal and thus sections 25-42 under Chapter VI provides for composition, procedure, power, jurisdiction etc. of the Appellate Tribunal. Chapter VII (Sections 43-47) deals with Special Courts, and Chapter VIII (Sections 48-54) provides for establishment of various authorities under the Act, their appointment, powers, jurisdiction etc. Chapter IX (Sections 55-61) deals with reciprocal arrangement for assistance in certain matters and procedure for attachment and confiscation of property. Chapter X containing Sections 62-75 deals with miscellaneous provisions including punishment for, vexatious search, false information etc., cognizance of offences, and offences by companies, among others.

## MAJOR PROVISIONS OF THE ACT

### Definitions

Section 2 of the Act defines various terms used in the Act. Some of the important definitions are given below:

### Attachment

Sub-section 1(d) defines attachment as to mean prohibition of transfer, conversion, disposition or movement of property by an order issued under Chapter III.

### Proceeds of Crime

Section 2(1)(u) defines the term 'proceeds of crime' as to mean any property derived or obtained, directly or indirectly by any person as a result of criminal activity relating to a scheduled offence or the value of any such property or where such property is taken or held outside the country, then the property equivalent in value held within the country or abroad.

### Property

The term 'property used in sub-section 1(v) of Section 2 means any property or assets of every description, whether, corporeal or incorporeal, movable or immovable, tangible or intangible and includes, deeds and instruments evidencing title to, or interest in such property or assets wherever located.

### Beneficial Owner

The term Beneficial Owner under Section 2 (1) (fa) means an individual who ultimately owns or controls a client of a reporting entity or the person on whose behalf a transaction is being conducted and includes a person who exercises ultimate effective control over a juridical person.

## Intermediary

The term intermediary under sub-section 1(n) of Section 2 has been defined as to mean a stock broker, sub- broker, share transfer agent, banker to an issue, trustee to a trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment advisor, and any other intermediary associated with securities market and registered under Section 12 of the SEBI Act, 1992 or an association recognised or registered under the Forward Contracts (Regulation) Act, 1952 or any member of such association; intermediary registered by the Pension Fund Regulatory and Development Authority; a recognised stock exchange referred to in clause (f) of section 2 of the Securities Contracts (Regulation) Act, 1956.

## Investigation

Sub-section 2(1)(na) defines investigation to include all the proceedings under the Act conducted by the Director or by an authority authorized by the Central Government under this Act for the collection of evidence.

## “Reporting entity”

As per Section 2(wa) “Reporting entity” means a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

## Scheduled offence

Section 2(1) (y) defines Scheduled Offence to include the offences specified under Part A of the Schedule, the offences specified under Part B of the Schedule if the total value involved in such offences is one crore rupees or more; the offences specified under Part C of the Schedule.

## Special Court

Section 2(1) (z) defines Special Court to means a Court of Session designated as Special Court under sub- section (1) of section 43.

## Transfer

Section 2(1) (za) defines transfer to includes sale, purchase, mortgage, pledge, gift, loan or any other form of transfer of right, title, possession or lien.

## Value

Section 2(1) (zb) defines value to mean the fair market value of any property on the date of its acquisition by any person, or if such date cannot be determined, the date on which such property is possessed by such person.

## Money Laundering

Section 3 of the Act states that whosoever directly or indirectly attempts to indulge or knowingly assists or knowingly is a party or actually involved in any process or activity connected with the proceeds of crime including its concealment, possession, acquisition or use and projecting or claiming it is an untainted property shall be guilty of offence of money laundering.

Section 4 provides that any person who commits the offence of money laundering shall be punishable with rigorous imprisonment for a term which shall not be less than three years but which may extend to seven years and also liable to fine. However, where the proceeds of crime involved in money laundering relates to any offence specified under the Narcotic Drugs and Psychotropic Substances Act, the punishment may extend to rigorous imprisonment for ten years.

## Attachment of property involved in money laundering

Section 5 of the Act authorises the Director or any officer not below the rank of Deputy Director authorised by him and who has reason to believe on the basis of material in his possession that any person is in possession of any proceeds of money laundering; such person has been charged of having committed a scheduled offence and such

proceeds of crime are likely to be concealed, transferred or dealt with in any manner which may result in frustrating any proceedings relating to confiscation of such proceeds of crime to, provisionally attach by order in writing such property for a period not exceeding 180 days from the date of the order.

The said provisional attachment does not debar the person who has the possession of the property from enjoying the same but the said person is prohibited from creating any third party interest in the said property.

The Director or any other officer who provisionally attaches any property is required to forward a copy of the order along with material in his possession to the Adjudicating Authority immediately and thereafter required to file, within a period of thirty days from such attachment file a complaint, stating the facts of such attachment before the Adjudicating Authority.

### Adjudicating Authority

Section 6 empowers the Central Government to appoint, by notification, one or more persons not below the prescribed rank or designation or having prescribed experience, as the Adjudicating Authority to exercise the jurisdiction, powers and authority conferred on or under the Act.

### Adjudication

Section 8 dealing with the adjudication. Section 8(1) states that on receipt of a complaint under sub-section (5) of section 5, or applications made under sub-section (4) of section 17 or under sub-section (10) of section 18, if the Adjudicating Authority has reason to believe that any person has committed an offence under section 3 or is in possession of proceeds of crime, it may serve a notice of not less than thirty days on such person calling upon him to indicate the sources of his income, earning or assets, out of which or by means of which he has acquired the property attached under sub-section (1) of section 5, or seized or frozen under section 17 or section 18, the evidence on which he relies and other relevant information and particulars, and to show cause why all or any of such properties should not be declared to be the properties involved in money-laundering and confiscated by the Central Government.

Provided that where a notice under this sub-section specifies any property as being held by a person on behalf of any other person, a copy of such notice shall also be served upon such other person.

Provided further that where such property is held jointly by more than one person, such notice shall be served to all persons holding such property.

According to Section 8(2) the Adjudicating Authority shall, after— (a) considering the reply, if any, to the notice issued under sub-section (1); (b) hearing the aggrieved person and the Director or any other officer authorised by him in this behalf; and (c) taking into account all relevant materials placed on record before him, by an order, record a finding whether all or any of the properties referred to in the notice issued under sub-section (1) are involved in money-laundering. Provided that if the property is claimed by a person, other than a person to whom the notice had been issued, such person shall also be given an opportunity of being heard to prove that the property is not involved in money-laundering.

Section 8(3) provides that where the Adjudicating Authority decides under sub-section (2) that any property is involved in money-laundering, he shall, by an order in writing, confirm the attachment of the property made under sub-section (1) of section 5 or retention of property or record seized or frozen under section 17 or section 18 and record a finding to that effect, whereupon such attachment or retention or freezing of the seized or frozen property or record shall—

- (a) continue during investigation for a period not exceeding three hundred and sixty-five days or the pendency of the proceedings relating to any offence under this Act before a court or under the corresponding law of any other country, before the competent court of criminal jurisdiction outside India, as the case may be; and
- (b) become final after an order of confiscation is passed under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 by the Special Court.

*Explanation.*—For the purposes of computing the period of three hundred and sixty-five days under clause (a), the period during which the investigation is stayed by any court under any law for the time being in force shall be excluded.

Section 8(4) states that where the provisional order of attachment made under sub-section (1) of section 5 has been confirmed under sub-section (3), the Director or any other officer authorised by him in this behalf shall forthwith take the possession of the property attached under section 5 or frozen under sub-section (1A) of section 17, in such manner as may be prescribed.

Provided that if it is not practicable to take possession of a property frozen under sub-section (1A) of section 17, the order of confiscation shall have the same effect as if the property had been taken possession of.

As per Section 8(5) where on conclusion of a trial of an offence under this Act, the Special Court finds that the offence of money-laundering has been committed, it shall order that such property involved in the money laundering or which has been used for commission of the offence of money-laundering shall stand confiscated to the Central Government.

Section 8(6) states that where on conclusion of a trial under this Act, the Special Court finds that the offence of money laundering has not taken place or the property is not involved in money-laundering, it shall order release of such property to the person entitled to receive it.

According to Section 8(7) where the trial under this Act cannot be conducted by reason of the death of the accused or the accused being declared a proclaimed offender or for any other reason or having commenced but could not be concluded, the Special Court shall, on an application moved by the Director or a person claiming to be entitled to possession of a property in respect of which an order has been passed under sub-section (3) of section 8, pass appropriate orders regarding confiscation or release of the property, as the case may be, involved in the offence of money-laundering after having regard to the material before it.

Section 8(8) provides that where a property stands confiscated to the Central Government under sub-section (5), the Special Court, in such manner as may be prescribed, may also direct the Central Government to restore such confiscated property or part thereof of a claimant with a legitimate interest in the property, who may have suffered a quantifiable loss as a result of the offence of money laundering: Provided that the Special Court shall not consider such claim unless it is satisfied that the claimant has acted in good faith and has suffered the loss despite having taken all reasonable precautions and is not involved in the offence of money laundering. Provided further that the Special Court may, if it thinks fit, consider the claim of the claimant for the purposes of restoration of such properties during the trial of the case in such manner as may be prescribed.

## Vesting of Property in Central Government

Section 9 provides that Where an order of confiscation has been made under sub-section (5) or sub-section (7) of section 8 or section 58B or sub-section (2A) of section 60 in respect of any property of a person, all the rights and title in such property shall vest absolutely in the Central Government free from all encumbrances: Where the Special Court or the Adjudicating Authority, as the case may be, after giving an opportunity of being heard to any other person interested in the property attached under this Chapter, or seized or frozen under Chapter V, is of the opinion that any encumbrance on the property or lease-hold interest has been created with a view to defeat the provisions of this Chapter, it may, by order, declare such encumbrance or lease-hold interest to be void and thereupon the aforesaid property shall vest in the Central Government free from such encumbrances or lease-hold interest.

It may be noted that nothing in this section shall operate to discharge any person from any liability in respect of such encumbrances which may be enforced against such person by a suit for damages.

## Obligation of Banking Companies, Financial Institutions and Intermediaries

Chapter IV of the Act deals with obligations of Banking companies, financial institutions and intermediaries. According to Section 12(1) requires every reporting entity shall—

- (a) maintain a record of all transactions, including information relating to transactions covered under clause (b), in such manner as to enable it to reconstruct individual transactions;
- (b) furnish to the Director within such time as may be prescribed, information relating to such transactions, whether attempted or executed, the nature and value of which may be prescribed.
- (c) maintain record of documents evidencing identity of its clients and beneficial owners as well as account files and business correspondence relating to its clients.

Section 12(2) provides that every information maintained, furnished or verified, save as otherwise provided under any law for the time being in force, shall be kept confidential.

Section 12(3) states that the records referred to in clause (a) of sub-section (1) shall be maintained for a period of five years from the date of transaction between a client and the reporting entity.

The records referred to in clause (e) of sub-section (1) shall be maintained for a period of five years after the business relationship between a client and the reporting entity has ended or the account has been closed, whichever is later.

The Central Government may, by notification, exempt any reporting entity or class of reporting entities from any obligation under this Chapter.

Section 13 states that the Director may, either on his own motion, or on an application made by any authority, officer, or person, call for records of all transactions and make such inquiry or cause such inquiry to be made, as he thinks fit. In the course of any inquiry, if the Director finds that a banking company, financial institution or an intermediary or any of its officers has failed to maintain or retain records in accordance with the provisions of the Act, he may, by an order, levy a fine on such banking company, financial institution or intermediary.

Section 15 empowers the Central Government to prescribe, in consultation with the Reserve Bank of India, the procedure and the manner of maintaining and furnishing information for the purpose of implementation of the provisions of the Act.

## Summon, Searches and Seizures, etc.

Section 16 empowers an authority to enter, on having reason to believe that an offence under Section 3 has been committed, any place within the limits of the area assigned to him or in respect of which he is authorised. Section 16(3) requires such authority to place marks of identification on the records inspected by him and make or cause to be made extracts or copies therefrom, make an inventory of any property checked or verified by him and record the statement of any person present in the place which may be useful for, or relevant to, any proceedings under the Act. Section 17 empowers authority to search and seizure.

Section 18 of the Act deals with search of persons and provides that if an authority authorised in this behalf by the Central Government by general or special order has reason to believe that any person has secreted about his person or in anything under his possession, ownership or control any record or proceeds of crime which may be useful for or relevant to any proceedings under this Act, he may search that person and seize such record or property which may be useful for or relevant to any proceedings under this Act.

## Retention of Property

Section 20 of the Act deals with retention of property.

1. Where any property has been seized under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the officer authorised by the Director in this behalf has, on the basis of material in his possession, reason to believe (the reason for such belief to be recorded by him in writing) that such property

is required to be retained for the purposes of adjudication under section 8, such property may, if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such property was seized or frozen, as the case may be.

2. The officer authorised by the Director shall, immediately after he has passed an order for retention or continuation of freezing of the property for purposes of adjudication under section 8, forward a copy of the order along with the material in his possession, referred to in sub-section (1), to the Adjudicating Authority, in a sealed envelope, in the manner as may be prescribed and such Adjudicating Authority shall keep such order and material for such period as may be prescribed.
3. On the expiry of the period specified in sub-section (1), the property shall be returned to the person from whom such property was seized or whose property was ordered to be frozen unless the Adjudicating Authority permits retention or continuation of freezing of such property beyond the said period.
4. The Adjudicating Authority, before authorising the retention or continuation of freezing of such property beyond the period specified in sub-section (1), shall satisfy himself that the property is *prima facie* involved in money-laundering and the property is required for the purposes of adjudication under section 8.
5. After passing the order of confiscation under sub-section (5) or sub-section (7) of section 8, the Special Court shall direct the release of all property other than the property involved in money-laundering to the person from whom such property was seized or the persons entitled to receive it.
6. Where an order releasing the property has been made by the Special Court under sub-section (6) of section 8 or by the Adjudicating Authority under section 58B or sub-section (2A) of section 60, the Director or any officer authorised by him in this behalf may withhold the release of any such property for a period of ninety days from the date of such order, if he is of the opinion that such property is relevant for the appeal proceedings under the Act.

### Retention of records

Section 21 deals with retention of records.

- (1) Where any records have been seized, under section 17 or section 18 or frozen under sub-section (1A) of section 17 and the Investigating Officer or any other officer authorised by the Director in this behalf has reason to believe that any of such records are required to be retained for any inquiry under this Act, such records may if seized, be retained or if frozen, may continue to remain frozen, for a period not exceeding one hundred and eighty days from the day on which such records were seized or frozen, as the case may be.
- (2) The person, from whom records seized or frozen, shall be entitled to obtain copies of records.
- (3) On the expiry of the period specified under sub-section (1), the records shall be returned to the person from whom such records were seized or whose records were ordered to be frozen unless the Adjudicating Authority permits retention or continuation of freezing of such records beyond the said period.
- (4) The Adjudicating Authority, before authorising the retention or continuation of freezing of such records beyond the period specified in sub-section (1), shall satisfy himself that the records are required for the purposes of adjudication under section 8.
- (5) After passing of an order of confiscation or release under sub-section (5) or subsection (7) of section 8 or Section 58B, the Adjudicating Authority shall direct the release of the records to the person from whom such records were seized.
- (6) Where an order releasing the records has been made by the Court, Adjudicating Authority under section 21(5), the Director or any officer authorised by him in this behalf may withhold the release of any such record for a period of ninety days from the date of such order, if he is of the opinion that such record is relevant for the appeal proceedings under the Act.

### Presumption in Inter-connected Transactions

Section 23 of the Act deals with presumption in inter-connected transactions and provides that where money laundering involves two or more transactions and one or more such transactions is or are proved to be involved in money laundering, then for the purposes of adjudication or confiscation under Section 8, it shall be presumed that

the remaining transactions form part of such interconnected transactions, unless otherwise proved to the satisfaction of the Adjudicating Authority.

### Appellate Tribunal

Chapter VI of the Act deals with Appellate Tribunal. Section 25 empowers the Central Government, to establish an Appellate Tribunal to hear appeals against the orders of Adjudicating Authority and other authorities under the Act.

The Appellate Tribunal constituted under sub-section (1) of section 12 of the Smugglers and Foreign Exchange Manipulators (Forfeiture of Property) Act, 1976 shall be the Appellate Tribunal for hearing appeals against the orders of the Adjudicating Authority and the other authorities under this Act. Section 26 lays down the matters where appeal lies to the Appellate Tribunal and which include orders made by Adjudicating Authority, reporting authority aggrieved by the order of the Director, etc. Further appeal from the orders of the Appellate Tribunal would lie to the High Court under Section 42 of the Act.

### Special Courts

Sections 43 to 47 of the Act deal with provisions relating to Special Courts. Section 43(1) empowers the Central Government to designate, in consultation with the Chief Justice of the High Court, one or more Courts of Session as Special Courts or Court for such area or areas or for such case or class or group of cases as may be specified in the notification, for trial of offence punishable under Section 4.

### Offences Triable by Special Courts

Section 44(1) provides that the offence punishable under Section 4, shall be triable only by the Special Court constituted for the area in which the offence has been committed or a special court may, upon a complaint made by an authority authorised in this behalf take cognizance of the offence for which the accused is committed to it for trial.

### Offences to be cognizable and Non-bailable

Section 45 declares every offence punishable under the Act to be cognizable. It provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, no person accused of an offence under this Act shall be released on bail or on his own bond unless the Public Prosecutor has been given an opportunity to oppose the application for such release; and where the Public Prosecutor opposes the application, unless the Court is satisfied that there are reasonable grounds for believing that he is not guilty of such offence and that he is not likely to commit any offence while in bail.

Provided that a person, who, is under the age of sixteen years, or is a woman or is sick or infirm, or is accused either on his own or along with other co-accused of money-laundering a sum of less than one crore rupees may be released on bail, if the Special Court so directs.

However the special court shall not take cognizance of any offence punishable under Section 4, except upon a complaint in writing made by (i) the Director or (ii) any officer of the Central Government or State Government authorised in writing in this behalf by the Central Government by a general or special order made by that Government.

Section 45(1A) provides that notwithstanding anything contained in Code of Criminal Procedure, 1973 or any other provision of this Act, no police officer shall investigate into an offence under this Act, unless specifically authorized, by the Central Government by a general or special order, and subject to such conditions as may be prescribed.

### Power of Central Government to Issue Directions

Section 52 empowers the Central Government to issue, from time to time, such orders, instructions and directions to the authorities as it may deem fit for the proper administration of this Act. The authorities and all other persons employed in execution of the Act have been put under obligation to observe and follow such orders, instructions and directions of the Central Government. However, no such orders, instructions or directions shall be issued so as to require any authority to decide a particular case in a particular manner or interfere with the discretion of the Adjudicating Authority in exercise of his functions.

## Agreement with Foreign Countries

Section 56 empowers the Central Government to enter into an agreement with the Government of any country for enforcing the provisions of the Act and also for exchange of information for the prevention of any offence under the this Act or under the corresponding law in force in that country or investigation of cases relating to any offence under the Act.

## Assistance to a Contracting State in Certain Cases

Section 58 provides that, where a letter of request is received by the Central Government, from a court or authority in a contracting State requesting for investigation into an offence or proceedings under the Act and forwarding to such court or authority any evidence connected therewith, the Central Government may forward such letter of request to the Special Court or to any authority as it thinks fit for execution of such request in accordance with the provisions of the Act or as the case may be, any other law for the time being in force. Section 58A empowering Special Court to release the property.

## Reciprocal Arrangements for Processes and Assistance for Transfer of Accused Persons

Section 59(1) prescribes that where Special Court, in relation to an offence punishable under Section 4 desires that a summon to an accused person; or a warrant for the arrest of an accused person; or a summon to any person requiring him to attend and produce a document or other thing, or to produce a document or other things or to produce it; or a search warrant issued by it, shall be served or executed at any place in any contracting state, it shall send such summons or warrant in duplicate in such form, to such court, Judge or Magistrate through such authorities as the Central Government may by notification, specify in that behalf and that court, Judge or Magistrate, as the case may be, shall cause the same to be executed.

Sub-Section (2) stipulates that where a Special Court, in relation to an offence punishable under Section 4 has received for service or execution, summon to an accused person; or a warrant for the arrest of an accused person; or a summon to any person requiring him to attend and produce a document or other things or to produce it; or a search warrant; issued by a court, Judge or Magistrate in a contracting State, it shall cause the same to be served or executed as if it were a summon or warrant received by it from another court in the said territories for service or execution within its jurisdiction. Where a warrant of arrest has been executed, the person arrested shall, so far as possible be dealt with in accordance with the procedure specified under Section 19 and where a search warrant has been executed, the things found in the search shall so far as possible be dealt with in accordance with the procedure specified under Section 17 or 18.

However, where a summon or search warrant received from a contracting state has been executed, the documents or other things produced or things found in the search shall be forwarded to the court issuing the summon or search warrant through such authority as the Central Government may by notification specify in this behalf.

## Attachment, Seizure and Confiscation of Property, etc.

Section 60(1) provides that where the Director has made an order for attachment of any property under Section 5 or for freezing under sub-section (1A) of section 17 or where an Adjudicating Authority has made an order relating to a property under section 8 or where a Special Court has made an order of confiscation relating to a property under sub-section (5) or sub section (6) of section 8 and such property is suspected to be in a contracting state, the Special Court on an application by the Director or the Administrator appointed under Section 10(1) as the case may be, may issue a letter of request to a court or an authority in the contracting state for execution of such order.

Section 60(2) prescribes that where a letter of request is received by the Central Government from a court or an authority in a contracting State requesting attachment, seizure, freezing or confiscation] of the property in India, derived or obtained, directly or indirectly, by any person from the commission of an offence under a corresponding law] committed in that contracting State, the Central Government may forward such letter of request to the Director, as it thinks fit, for execution in accordance with the provisions of this Act.

Section 60(2A) states that where on closure of the criminal case or conclusion of trial in a criminal court outside India under the corresponding law of any other country, such court finds that the offence of money-laundering under the corresponding law of that country has been committed, the Special Court shall, on receipt of an application from the Director for execution of confiscation under sub-section (2), order, after giving notice to the affected persons, that such property involved in money-laundering or which has been used for commission of the offence of money-laundering stand confiscated to the Central Government.

Sub-Section (3) stipulates that the Director shall on receipt of a letter of request under Section 58 or Section 59 direct any authority under the Act to take all steps necessary for tracing and identifying such property.

### (KYC) Norms/ (AML) Measures/ (CFT) Guidelines – Anti Money Laundering Standards

In terms of the provisions of Prevention of Money-Laundering Act, 2002 and the Prevention of Money- Laundering (Maintenance of Records) Rules, 2005, as amended from time to time by the Government of India, regulated/ reporting entities are required to follow certain customer identification procedures while undertaking a transaction either by establishing an account-based relationship or otherwise and monitor their transactions. Regulate entities are required to take steps to implement the provisions of the aforementioned Act and Rules, including operational instructions issued in pursuance of such amendment(s).

RBI issue Circular from time to time on Know Your Customer (KYC) norms/Anti-Money Laundering (AML) standards/Combating of Financing of Terrorism (CFT)/Obligation of banks under Prevention of Money Laundering Act, (PMLA), 2002 and Banks were advised to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority. These 'Know Your Customer' guidelines have been revisited in the context of the Recommendations made by the Financial Action Task Force (FATF) on Anti Money Laundering (AML) standards and on Combating Financing of Terrorism (CFT). These standards have become the international benchmark for framing Anti Money Laundering and combating financing of terrorism policies by the regulatory authorities. Compliance with these standards by the banks/financial institutions/NBFCs in the country have become necessary for international financial relationships. Banks have been advised to ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures are adopted with the approval of the Board and put in place.

#### The objective of KYC Norms/ AML Measures/ CFT Guidelines

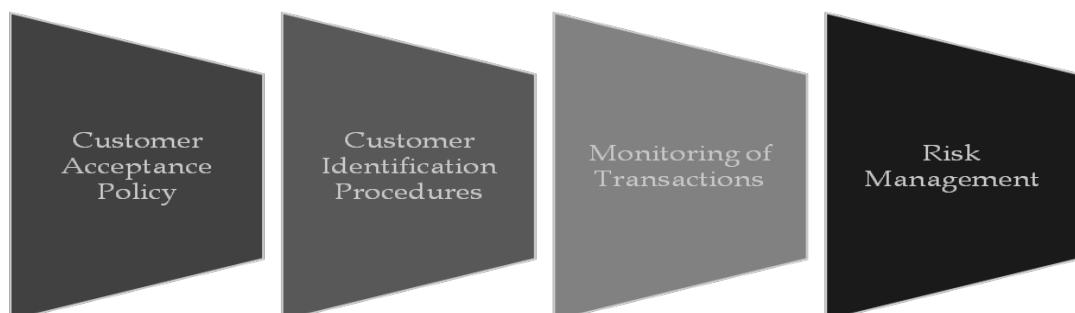
The objective of Know Your Customer (KYC) Norms/Anti-Money Laundering (AML) Measures/Combating of Financing of Terrorism (CFT) guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently.

#### Obligation of Banks

- Banks should keep in mind that the information collected from the customer for the purpose of opening of account is to be treated as confidential and details thereof are not to be divulged for cross selling or any other like purposes. Banks should, therefore, ensure that information sought from the customer is relevant to the perceived risk, is not intrusive, and is in conformity with the guidelines issued in this regard. Any other information from the customer should be sought separately with his/her consent and after opening the account.
- Banks should ensure that the provisions of Foreign Contribution (Regulation) Act, 2010 and the Foreign Exchange Management Act, 1999 as amended from time to time, wherever applicable are strictly adhered to.

#### KYC Policy

Banks should frame their KYC policies incorporating the following four key elements:



For the purpose of KYC policy, a 'Customer' is defined as:

- a person or entity that maintains an account and/or has a business relationship with the bank;
- one on whose behalf the account is maintained (i.e. the beneficial owner);
- beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc. as permitted under the law, and
- any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.

### **Introduction of New Technologies – Credit cards/debit cards/ smart cards/gift cards**

Banks should pay special attention to any money laundering threats that may arise from new or developing technologies including internet banking that might favour anonymity, and take measures, if needed, to prevent their use in money laundering schemes. Many banks are engaged in the business of issuing a variety of Electronic Cards that are used by customers for buying goods and services, drawing cash from ATMs, and can be used for electronic transfer of funds. Banks are required to ensure full compliance with all KYC/AML/CFT guidelines issued from time to time, in respect of add-on/ supplementary cardholders also. Further, marketing of credit cards is generally done through the services of agents. Banks should ensure that appropriate KYC procedures are duly applied before issuing the cards to the customers. It is also desirable that agents are also subjected to KYC measures.

#### **Information to be preserved**

Banks are required to maintain all necessary information in respect of transactions to permit reconstruction of individual transaction, including the following information:

- (a) the nature of the transactions;
- (b) the amount of the transaction and the currency in which it was denominated;
- (c) the date on which the transaction was conducted; and
- (d) the parties to the transaction

### **Maintenance and Preservation of record**

- (a) Banks are required to maintain the records containing information of all transactions. Banks should take appropriate steps to evolve a system for proper maintenance and preservation of account information in a manner that allows data to be retrieved easily and quickly whenever required or when requested by the competent authorities.
- (b) Banks should ensure that records pertaining to the identification of the customer and his address (e.g. copies of documents like passports, identity cards, driving licenses, PAN card, utility bills etc.) obtained while opening the account and during the course of business relationship, are properly preserved. The identification records and transaction data should be made available to the competent authorities upon request.
- (c) Banks have been advised to pay special attention to all complex, unusual large transactions and all unusual patterns of transactions, which have no apparent economic or visible lawful purpose. It is further clarified that the background including all documents/office records/memorandums pertaining to such transactions and purpose thereof should, as far as possible, be examined and the findings at branch as well as Principal Officer level should be properly recorded. Such records and related documents should be made available to help auditors in their day-to-day work relating to scrutiny of transactions and also to Reserve Bank/other relevant authorities.

#### **Reporting to Financial Intelligence Unit – India**

In terms of the PMLA Rules, banks are required to report information relating to cash and suspicious transactions and all transactions involving receipts by non-profit organisations of value more than rupees ten lakh or its equivalent in foreign currency to the Director, Financial Intelligence Unit-India (FIU-IND) in respect of transactions.

## Freezing of Assets under Section 51A of Unlawful Activities (Prevention) Act, 1967

The Unlawful Activities (Prevention) Act, 1967 (UAPA) enacted by the Parliament for the more effective prevention of certain unlawful activities of individual and association and for dealing with terrorist activities. In terms of Section 51A, the Central Government is empowered to freeze, seize or attach funds and other financial assets or economic resources held by, on behalf of or at the direction of the individuals or entities Listed in the Schedule to the Order, or any other person engaged in or suspected to be engaged in terrorism and prohibit any individual or entity from making any funds, financial assets or economic resources or related services available for the benefit of the individuals or entities Listed in the Schedule to the Order or any other person engaged in or suspected to be engaged in terrorism.

### LESSON ROUND-UP

- Money laundering is the processing of criminal proceeds to disguise its illegal origin.
- The process of money laundering can be classified into three stages, namely, placement, layering and integration.
- The Prevention of Money-laundering Act, 2002 was enacted to prevent money laundering and to provide for confiscation of property derived from, or involved in, money laundering and for matters connected therewith or incidental thereto.
- The Act also addresses the international obligations under the Political Declaration and Global Programme of Action adopted by the General Assembly of the United Nations to prevent money laundering.
- The Act contains provisions pertaining to offences and punishment for money laundering, attachment, adjudication and confiscation, obligations of banking companies, financial institutions and intermediaries, Summons, Searches and Seizures etc.
- The Act states that whoever, acquires, owns, possesses, or transfers any proceeds of crime or knowingly enters into any transaction which is related to proceeds of crime directly or indirectly or conceals or aids in the concealment of the proceeds of crime, shall be guilty of offence of money laundering.
- Every banking company, financial institution and intermediary is required to maintain a record of all transactions, the nature and value of which may be prescribed, whether such transactions comprise of a single transaction or a series of transactions legally connected to each other, and when such series of transactions take place within a month.
- The objective of Know Your Customer (KYC) Norms/Anti-Money Laundering (AML) Measures/ Combating of Financing of Terrorism (CFT) guidelines is to prevent banks from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks to know/understand their customers and their financial dealings better which in turn help them manage their risks prudently.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define the term money laundering and explain the process of money laundering.
2. Briefly discuss the international efforts in preventing the money laundering.
3. Briefly explain the salient features of Prevention of Money Laundering Act.
4. Write short note on the following:
  - (a) Impact of money laundering on the Development.
  - (b) Obligation of banking companies, financial institutions and intermediaries.
  - (c) Attachment, seizure and confiscation of property etc.
5. What are the objectives of KYC guidelines and when does KYC norms apply?

## Lesson 20

# Indian Contract Act, 1872

### ***Key Concepts One Should Know***

- Agreement
- Contract
- Void Agreement
- Quantum Meruit
- Contingent Contract
- Quasi Contract
- Bailment and Pledge
- E-Contract

### ***Learning Objectives***

#### **To understand:**

- General Principles relating to the formation and Enforceability of Contracts
- Rules Governing the provisions of an Agreement and Offer
- Types of Contracts
- Indemnity and Guarantee
- Breach of a Contract
- Del Credere Agent

### ***Regulatory Framework***

- Indian Contract Act, 1872

### ***Lesson Outline***

- Meaning and Nature of contract
- Agreement
- Essential elements of a valid contract
- Flaws in Contract
- Agreement that restrained of Trade
- Wagering Agreement
- Void Agreement
- Quantum Meruit
- Restitution
- Contingent Contract
- Quasi Contract
- Contract of Indemnity Guarantee
- Remedies for Breach
- Contract of Bailment and Pledge
- Law of Agency
- Joint Venture Agreements
- E-Contract
- LESSON ROUND-UP
- TEST YOURSELF

## MEANING AND NATURE OF CONTRACT

The law relating to contract is governed by the Indian Contract Act, 1872. The Act came into force on the first day of September, 1872. The preamble to the Act says that it is an Act "to define and amend certain parts of the law relating to contract". It extends to the whole of India except the State of Jammu and Kashmir. The Act is by no means exhaustive on the law of contract. It does not deal with all the branches of the law of contract. Thus, contracts relating to partnership, sale of goods, negotiable instruments, insurance etc. are dealt with by separate Acts.

The Indian Contract Act mostly deals with the general principles and rules governing contracts. The Act is divisible into two parts. The first part (Section 1-75) deals with the general principles of the law of contract, and therefore applies to all contracts irrespective of their nature. The second part (Sections 124-238) deals with certain special kinds of contracts, namely contracts of Indemnity and Guarantee, Bailment, Pledge, and Agency.

The Indian Contract Act has defined contract in Section 2(h) as "an agreement enforceable by law".

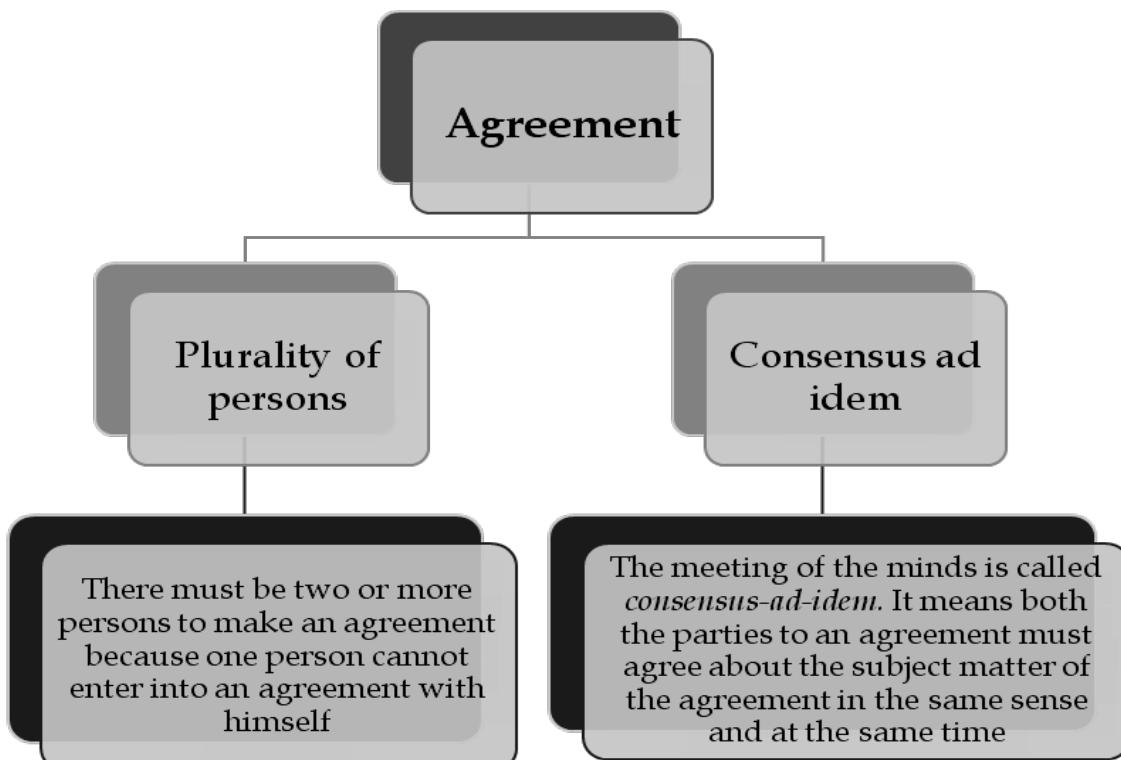
These definitions indicate that a contract essentially consists of two distinct parts. First, there must be an agreement. Secondly, such an agreement must be enforceable by law. To be enforceable, an agreement must be coupled with an obligation.

A contract therefore, is a combination of the two elements: (1) an agreement and (2) an obligation.

### Agreement

An agreement gives birth to a contract. As per Section 2(e) of the Indian Contract Act "every promise and every set of promises, forming the consideration for each other, is an agreement. It is evident from the definition given above that an agreement is based on a promise. What is a promise? According to Section 2(b) of the Indian Contract Act "when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted, becomes a promise. An agreement, therefore, comes into existence when one party makes a proposal or offer to the other party and that other party signifies his assent thereto. In nutshell, an agreement is the sum total of offer and acceptance."

*An analysis of the definition given above reveals the following characteristics of an agreement:*



## Obligation

An obligation is the legal duty to do or abstain from doing what one has promised to do or abstain from doing. A contractual obligation arises from a bargain between the parties to the agreement who are called the promisor and the promisee. Section 2(b) says that when the person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted; and a proposal when accepted becomes a promise. In broad sense, therefore, a contract is an exchange of promises by two or more persons, resulting in an obligation to do or abstain from doing a particular act, where such obligation is recognised and enforced by law.

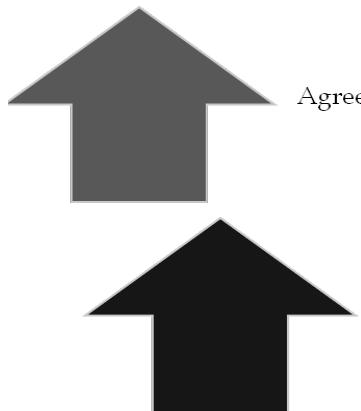
### Rights and Obligations

Where parties have made a binding contract, they have created rights and obligations between themselves. The contractual rights and obligations are correlative, e.g., A agrees with B to sell his car for Rs. 10,000 to him. In this example, the following rights and obligations have been created:

- (i) A is under an obligation to deliver the car to B. B has a corresponding right to receive the car.
- (ii) B is under an obligation to pay Rs. 10,00,000 to A. A has a correlative right to receive Rs. 10,00,000.

### Agreements which are not Contracts

Agreements in which the idea of bargain is absent and there is no intention to create legal relations are not contracts. These are:



Agreements relating to social matters

Domestic arrangements between husband and wife

- (a) Agreements relating to social matters: An agreement between two persons to go together to the cinema, or for a walk, does not create a legal obligation on their part to abide by it. Similarly, if I promise to take you for a dinner and break that promise, I do not expect to be liable to legal penalties. There cannot be any offer and acceptance to hospitality.
- (b) Domestic arrangements between husband and wife: In *Balfour v. Balfour* (1919) 2 KB 571, a husband working in Ceylon, had agreed in writing to pay a housekeeping allowance to his wife living in England. On receiving information that she was unfaithful to him, he stopped the allowance. Held, he was entitled to do so. This was a mere domestic arrangement with no intention to create legally binding relations. Therefore, there was no contract.

#### *Three consequences follow from the above discussion:*

- (i) To constitute a contract, the parties must intend to create legal relationship.
- (ii) The law of contract is the law of those agreements which create obligations, and those obligations which have their source in agreement.
- (iii) Agreement is the genus of which contract is the specie and, therefore, all contracts are agreements but all agreements are not contracts.

## ESSENTIAL ELEMENTS OF A VALID CONTRACT

Section 10 of the Indian Contract Act, 1872 provides that “all agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void”.

***The essential elements of a valid contract are:***

- (i) An offer or proposal by one party and acceptance of that offer by another party resulting in an agreement – *consensus-ad-idem*.
- (ii) An intention to create legal relations or an intent to have legal consequences.
- (iii) The agreement is supported by a lawful consideration.
- (iv) The parties to the contract are legally capable of contracting.
- (v) Genuine consent between the parties.
- (vi) The object and consideration of the contract is legal and is not opposed to public policy.
- (vii) The terms of the contract are certain.
- (viii) The agreement is capable of being performed i.e., it is not impossible of being performed.

Therefore, to form a valid contract there must be (1) an agreement, (2) based on the genuine consent of the parties, (3) supported by a lawful consideration, (4) made for a lawful object, and (iv) between the competent parties.

### (i) Offer or Proposal and Acceptance

One of the early steps in the formation of a contract lies in arriving at an agreement between the contracting parties by means of an offer and acceptance. Thus, when one party (the offeror) makes a definite proposal to another party (the offeree) and the offeree accepts it in its entirety and without any qualification, there is a meeting of the minds of the parties and a contract comes into being, assuming that all other elements are also present.

### What is an Offer or a Proposal?

A proposal is also termed as an offer. The word ‘proposal’ is synonymous with the English word “offer”. An offer is a proposal by one person, whereby he expresses his willingness to enter into a contractual obligation in return for a promise, act or forbearance. Section 2(a) of the Indian Contract Act defines proposal or offer as “when one person signifies to another his willingness to do or abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal”. The person making the proposal or offer is called the *proposer or offeror* and the person to whom the proposal is made is called the *offeree*.

### Rules Governing Offers

A valid offer must comply with the following rules:

- (a) An offer must be clear, definite, complete and final. It must not be vague. For example, a promise to pay an increased price for a horse if it proves lucky to promisor, is too vague and is not binding.
- (b) An offer must be communicated to the offeree. An offer becomes effective only when it has been communicated to the offeree so as to give him an opportunity to accept or reject the same.
- (c) The communication of an offer may be made by express words-oral or written-or it may be implied by conduct. A offers his car to B for ₹10,000. It is an express offer. A bus plying on a definite route goes along the street. This is an implied offer on the part of the owners of the bus to carry passengers at the scheduled fares for the various stages.
- (d) The communication of the offer may be general or specific. Where an offer is made to a specific person it is called specific offer and it can be accepted only by that person. But when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a general offer and can be accepted by any member of the

general public by fulfilling the condition laid down in the offer. The leading case on the subject is *Carlill v. Carbolic Smoke Ball Co.* The company offered by advertisement, a reward of '100 to anyone who contacted influenza after using their smoke ball in the specified manner. Mrs. Carlill did use smoke ball in the specified manner, but was attacked by influenza. She claimed the reward and it was held that she could recover the reward as general offer can be accepted by anybody. Since this offer is of a continuing nature, more than one person can accept it and can even claim the reward. But if the offer of reward is for seeking some information or seeking the restoration of missing thing, then the offer can be accepted by one individual who does it first of all. The condition is that the claimant must have prior knowledge of the reward before doing that act or providing that information.

*Example:* A advertises in the newspapers that he will pay rupees one thousand to anyone who brings to him his lost son. B without knowing of this reward finds A's lost son and restore him to A. In this case since B did not know of the reward, he cannot claim it from A even though he finds A's lost son and brings him to A.

In India also, in the case of *Harbhajan Lal v. Harcharan Lal* (AIR 1925 All. 539), the same rule was applied. In this case, a young boy ran away from his father's home. The father issued a pamphlet offering a reward of '500 to anybody who would bring the boy home. The plaintiff saw the boy at a railway station and sent a telegram to the boy's father. It was held that the handbill was an offer open to the world at large and was capable to acceptance by any person who fulfilled the conditions contained in the offer. The plaintiff substantially performed the conditions and was entitled to the reward offered.

### An Offer must be Distinguished from

- (a) *An invitation to treat or an invitation to make an offer:* e.g., an auctioneer's request for bids (which are offered by the bidders), the display of goods in a shop window with prices marked upon them, or the display of priced goods in a self-service store or a shopkeeper's catalogue of prices are invitations to an offer.
- (b) *A mere statement of intention:* e.g., an announcement of a coming auction sale. Thus, a person who attended the advertised place of auction could not sue for breach of contract if the auction was cancelled (*Harris v. Nickerson* (1873) L.R. 8 QB 286).
- (c) *A mere communication of information in the course of negotiation:* e.g., a statement of the price at which one is prepared to consider negotiating the sale of a piece of land (*Harvey v. Facey* (1893) A.C. 552).

An offer that has been communicated properly continues as such until it lapses, or until it is revoked by the offeror, or rejected or accepted by the offeree.

### Lapse of Offer

Section 6 deals with various modes of lapse of an offer. It states that an offer lapses if—

- (a) it is not accepted within the specified time (if any) or after a reasonable time, if none is specified.
- (b) it is not accepted in the mode prescribed or if no mode is prescribed in some usual and reasonable manner, e.g., by sending a letter by mail when early reply was requested;
- (c) the offeree rejects it by distinct refusal to accept it;
- (d) either the offeror or the offeree dies before acceptance;
- (e) the acceptor fails to fulfill a condition precedent to an acceptance.
- (f) the offeree makes a counter offer, it amounts to rejection of the offer and an offer by the offeree may be accepted or rejected by the offeror.

### Revocation of Offer by the Offeror

An offer may be revoked by the offeror at any time before acceptance.

Like any offer, revocation must be communicated to the offeree, as it does not take effect until it is actually communicated to the offeree. Before its actual communication, the offeree, may accept the offer and create a binding contract. The revocation must reach the offeree before he sends out the acceptance.

An offer to keep open for a specified time (option) is not binding unless it is supported by consideration.

### Acceptance

A contract emerges from the acceptance of an offer. Acceptance is the act of assenting by the offeree to an offer. Under Section 2(b) of the Contract Act when a person to whom the proposal is made signifies his assent thereto, the proposal is said to be accepted. A proposal, when accepted becomes a promise..

### Rules Governing Acceptance

- (a) Acceptance may be express i.e. by words spoken or written or implied from the conduct of the parties.
- (b) If a particular method of acceptance is prescribed, the offer must be accepted in the prescribed manner.
- (c) Acceptance must be unqualified and absolute and must correspond with all the terms of the offer.
- (d) A counter offer or conditional acceptance operates as a rejection of the offer and causes it to lapse, e.g., where a horse is offered for Rs. 1,000 and the offeree counter-offers Rs. 990, the offer lapses by rejection.
- (e) Acceptance must be communicated to the offeror, for acceptance is complete the moment it is communicated. Where the offeree merely intended to accept but does not communicate his intention to the offeror, there is no contract. Mere mental acceptance is not enough.
- (f) Mere silence on the part of the offeree does not amount to acceptance.

Ordinarily, the offeror cannot frame his offer in such a way as to make the silence or inaction of the offeree as an acceptance. In other words, the offeror can prescribe the mode of acceptance but not the mode of rejection.

- (g) If the offer is one which is to be accepted by being acted upon, no communication of acceptance to the offeror is necessary, unless communication is stipulated for in the offer itself.

Thus, if a reward is offered for finding a lost dog, the offer is accepted by finding the dog after reading about the offer, and it is unnecessary before beginning to search for the dog to give notice of acceptance to the offeror.

- (h) Acceptance must be given within a reasonable time and before the offer lapses or is revoked. An offer becomes irrevocable by acceptance.

An acceptance never precedes an offer. There can be no acceptance of an offer which is not communicated. Similarly, performance of conditions of an offer without the knowledge of the specific offer, is no acceptance. Thus in *Lalman Shukla v. Gauri Dutt* (1913), where a servant brought the boy without knowing of the reward, he was held not entitled to reward because he did not know about the offer.

### Standing Offers

Where a person offers to another to supply specific goods, up to a stated quantity or in any quantity which may be required, at a certain rate, during a fixed period, he makes a standing offer. Thus, a tender to supply goods as and when required, amounts to a standing offer.

A standing offer or a tender is of the nature of a continuing offer. An acceptance of such an offer merely amounts to intimation that the offer will be considered to remain open during the period specified and that it will be accepted from time to time by placing order for specified quantities. Each successive order given, while the offer remains in force, is an acceptance of the standing offer as to the quantity ordered, and creates a separate contract. It does not bind either party unless and until such orders are given.

Where P tendered to supply goods to L upto a certain amount and over a certain period, L's order did not come up to the amount expected and P sued for breach of contract *Held*: Each order made was a separate contract and P was bound to fulfill orders made, but there was no obligation on L to make any order to all (*Percival Ltd. vs. L.C.C.* (1918)).

## Tickets

Tickets purchased for entrance into places of amusement, or tickets issued by railways or bus companies, clock-room tickets, and many other contracts set out in printed documents contain numerous terms, of many of which the party receiving the ticket or document is ignorant. If a passenger on a railway train receives a ticket on the face of which is printed "this ticket is issued subject to the notices, regulations and conditions contained in the current time-tables of the railway", the regulations and conditions referred to are deemed to be communicated to him and he is bound by them whether or not he has read them. He is bound even if he is illiterate and unable to read them. But it is important that the notice of the conditions is contemporaneous with the making of the contract and not after the contract has been made.

## Contracts by Post

Contracts by post are subject to the same rules as others, but because of their importance, these are stated below separately:

- (a) An offer by post may be accepted by post, unless the offeror indicates anything to the contrary.
  - (b) An offer is made only when it actually reaches the offeree and not before, i.e., when the letter containing the offer is delivered to the offeree.
  - (c) An acceptance is made as far as the offeror is concerned, as soon as the letter containing the acceptance is posted, to offerors correct address; it binds the offeror, but not the acceptor.
- An acceptance binds the acceptor only when the letter containing the acceptance reaches the offeror. The result is that the acceptor can revoke his acceptance before it reaches the offeror.
- (d) An offer may be revoked before the letter containing the acceptance is posted. An acceptance can be revoked before it reaches the offeror.

## Contracts over the Telephone

Contracts over the telephone are regarded the same in principle as those negotiated by the parties in the actual presence of each other. In both cases an oral offer is made and an oral acceptance is expected. It is important that the acceptance must be audible, heard and understood by the offeror. If during the conversation the telephone lines go "dead" and the offeror does not hear the offerees word of acceptance, there is no contract at the moment. If the whole conversation is repeated and the offeror hears and understands the words of acceptance, the contract is complete (*Kanhayalal v. Dineshwarchandra* (1959) AIR, M.P. 234).

### (ii) Intention to Create Legal Relations

The second essential element of a valid contract is that there must be an intention among the parties that the agreement should be attached by legal consequences and create legal obligations. If there is no such intention on the part of the parties, there is no contract between them. Agreements of a social or domestic nature do not contemplate legal relationship. As such they are not contracts.

A proposal or an offer is made with a view to obtain the assent to the other party and when that other party expresses his willingness to the act or abstinence proposed, he accepts the offer and a contract is made between the two. But both offer and acceptance must be made with the intention of creating legal relations between the parties. The test of intention is objective. The Courts seek to give effect to the presumed intention of the parties. Where necessary, the Court would look into the conduct of the parties, for much can be inferred from the conduct. The Court is not concerned with the mental intention of the parties, but rather with what a reasonable man would say, was the intention of the parties, having regard to all the circumstances of the case.

For example, if two persons agree to assist each other by rendering advice, in the pursuit of virtue, science or art, it cannot be regarded as a contract. In commercial and business agreements, the presumption is usually that the parties intended to create legal relations. But this presumption is rebuttable which means that it must be shown that the parties did not intend to be legally bound.

### (iii) Lawful Consideration

#### Need for Consideration

Consideration is one of the essential elements of a valid contract. The requirement of consideration stems from the policy of extending the arm of the law to the enforcement of mutual promises of parties. A mere promise is not enforceable at law. For example, if A promises to make a gift of `500 to B, and subsequently changes his mind, B cannot succeed against A for breach of promise, as B has not given anything in return. It is only when a promise is made for something in return from the promisee, that such promise can be enforced by law against the promisor. This something in return is the consideration for the promise.

#### Definition of Consideration

Sir Fredrick Pollock has defined consideration "as an act or forbearance of one party, or the promise thereof is the price for which the promise of the other is bought".

It is "some right, interest, profit, or benefit accruing to one party or some forbearance, detriment, loss or responsibility, given, suffered or undertaken by the other" (*Currie v. Misa* (1875) L.R. 10 Ex. 153).

Section 2(d) of the Indian Contract Act, 1872 defines consideration thus: "when at the desire of the promisor, the promisee or any other person has done or abstained from doing, or does or abstains from doing, or promises to do or to abstain from doing something, such act or abstinence or promise is called a consideration for the promise".

The fundamental principle that consideration is essential in every contract, is laid down by both the definitions but there are some important points of difference in respect of the nature and extent of consideration and parties to it under the two systems:

- (a) Consideration at the desire of the promisor: Section 2(d) of the Act begins with the statement that consideration must move at the desire or request of the promisor. This means that whatever is done must have been done at the desire of the promisor and not voluntarily or not at the desire of a third party. If A rushes to B's help whose house is on fire, there is no consideration but a voluntary act. But if A goes to B's help at B's request, there is good consideration as B did not wish to do the act gratuitously.
- (b) Consideration may move from the promisee or any other person: In English law, consideration must move from the promisee, so that a stranger to the consideration cannot sue on the contract. A person seeking to enforce a simple contract must prove in court that he himself has given the consideration in return for the promise he is seeking to enforce.

In Indian law, however, consideration may move from the promisee or any other person, so that a stranger to the consideration may maintain a suit. In *Chinnaya v. Ramaya*, (1882) 4 Mad. 137, a lady by a deed of gift made over certain property to her daughter directing her to pay an annuity to the donor's brother as had been done by the donor herself before she gifted the property. On the same day, her daughter executed in writing in favour of the donor's brother agreeing to pay the annuity. Afterwards the donee (the daughter) declined to fulfil her promise to pay her uncle saying that no consideration had moved from him. The Court, however, held that the uncle could sue even though no part of the consideration received by his niece moved from him. The consideration from her mother was sufficient consideration.

#### Privity of Contract

A stranger to a contract cannot sue both under the English and Indian law for want of privity of contract. The following illustration explains this point.

In *Dunlop Pneumatic Tyre Co. v. Selfridge Ltd.* (1915) A.C. 847, D supplied tyres to a wholesaler X, on condition that any retailer to whom X re-supplied the tyres should promise X, not to sell them to the public below D's list price. X supplied tyres to S upon this condition, but nevertheless S sold the tyres below the list price. Held: There was a contract between D and X and a contract between X and S. Therefore, D could not obtain damages from S, as D had not given any consideration for S's promise to X nor was he party to the contract between D and X.

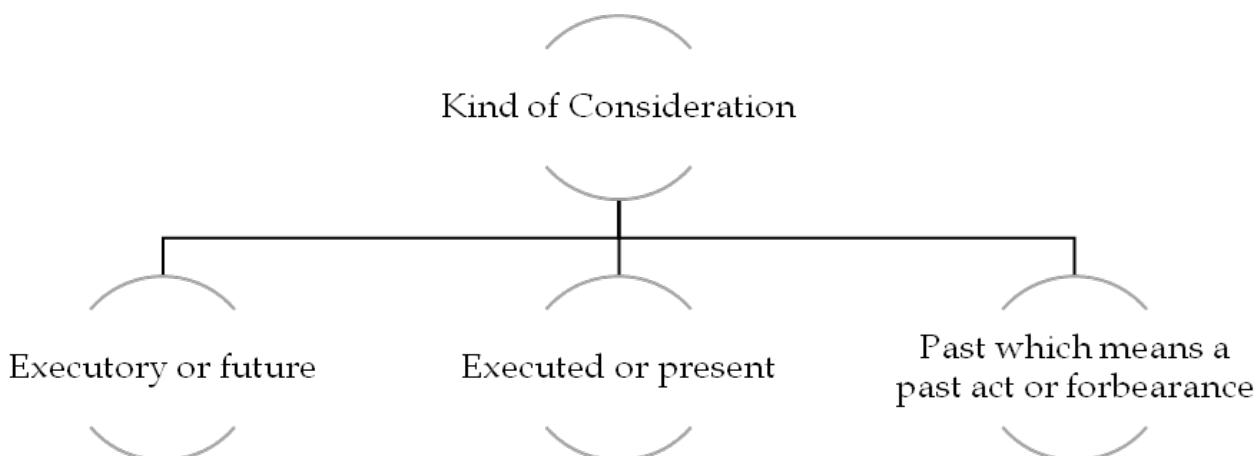
Thus, a person who is not a party to a contract cannot sue upon it even though the contract is for his benefit. A, who is indebted to B, sells his property to C, and C the purchaser of the property, promises to pay off the debt to B. In case C fails to pay B, B has no right to sue C for there is no privity of contract between B and C.

The leading English case on the point is *Tweddle v. Atkinson* (1861) 1B and Section 393. In this case, the father of a boy and the father of a girl who was to be married to the boy, agreed that each of them shall pay a sum of money to the boy who was to take up the new responsibilities of married life. After the demise of both the contracting parties, the boy (the husband) sued the executors of his father-in-law upon the agreement between his father-in-law and his father. *Held:* the suit was not maintainable as the boy was not a party to the contract.

*Exception to the doctrine of privity of contract:* Both the Indian law and the English law recognize certain exceptions to the rule that a stranger to a contract cannot sue on the contract. In the following cases, a person who is not a party to a contract can enforce the contract:

- (i) A beneficiary under an agreement to create a trust can sue upon the agreement, though not a party to it, for the enforcement of the trust so as to get the trust executed for his benefit. In *Khawaja Muhammad v. Hussaini Begum*, (1910) 32 All. 410, it was held that where a Mohammedan lady sued her father-in-law to recover arrears of allowance payable to her by him under an agreement between him and her own father in consideration of her marriage, she could enforce the promise in her favour in so far as she was a beneficiary under the agreement to make a settlement in her favour, and she was claiming as beneficiary under such settlement.
- (ii) An assignee under an assignment made by the parties, or by the operation of law (e.g. in case of death or insolvency), can sue upon the contract for the enforcement of his rights, title and interest. But a mere nominee (i.e., the person for whose benefit another has insured his own life) cannot sue on the policy because the nominee is not an assignee.
- (iii) In cases of family arrangements or settlements between male members of a Hindu family which provide for the maintenance or expenses for marriages of female members, the latter though not parties to the contract, possess an actual beneficial right which place them in the position of beneficiaries under the contract, and can therefore, sue.
- (iv) In case of acknowledgement of liability, e.g., where A receives money from B for paying to C, and admits to C the receipt of that amount, then A constitutes himself as the agent of C.
- (v) Whenever the promisor is by his own conduct estopped from denying his liability to perform the promise, the person who is not a party to the contract can sue upon it to make the promisor liable.
- (vi) In cases where a person makes a promise to an individual for the benefit of third party and creates a charge on certain immovable property for the purpose, the third party can enforce the promise though, he is stranger to the contract.

## Kinds of Consideration



Consideration may be:

- (a) Executory or future which means that it makes the form of promise to be performed in the future, e.g., an engagement to marry someone; or
- (b) Executed or present in which it is an act or forbearance made or suffered for a promise. In other words, the act constituting consideration is wholly or completely performed, e.g., if A pays today Rs. 100 to a shopkeeper for goods which are promised to be supplied the next day, A has executed his consideration but the shopkeeper is giving executory consideration—a promise to be executed the following day. If the price is paid by the buyer and the goods are delivered by the seller at the same time, consideration is executed by both the parties.
- (c) Past which means a past act or forbearance, that is to say, an act constituting consideration which took place and is complete (wholly executed) before the promise is made.

According to English law, a consideration may be executory or executed but never past. The English law is that past consideration is no consideration. *The Indian law recognizes all the above three kinds of consideration.*

### Rules Governing Consideration

- (a) Every simple contact must be supported by valuable consideration otherwise it is formally void subject to some exceptions.
- (b) Consideration may be an act of abstinence or promise.
- (c) There must be mutuality i.e., each party must do or agree to do something. A gratuitous promise as in the case of subscription for charity, is not enforceable. For example, where A promises to subscribe '5,000 for the repair of a temple, and then refuses to pay, no action can be taken against him.
- (d) Consideration must be real, and not vague, indefinite, or illusory, e.g., a son's promise to "stop being a nuisance" to his father, being vague, is no consideration.
- (e) Although consideration must have some value, it need not be adequate i.e., a full return for the promise. Section 25 (Exp. II) clearly provides that "an agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate". It is upon the parties to fix their own prices. For example, where A voluntarily agreed to sell his motor car for '500 to B, it became a valid contract despite the inadequacy of the consideration.
- (f) Consideration must be lawful, e.g., it must not be some illegal act such as paying someone to commit a crime. If the consideration is unlawful, the agreement is void.
- (g) Consideration must be something more than the promisee is already bound to do for the promisor. Thus, an agreement to perform an existing obligation made with the person to whom the obligation is already owed, is not made for consideration. For example, if a seaman deserts his ship so breaking his contract of service and is induced to return to his duty by the promise for extra wages, he cannot later sue for the extra wages since he has only done what he had already contracted for: *Stilk v. Myrick* (1809).

### When Consideration not Necessary

The general rule is that an agreement made without consideration is void. But Section 25 of the Indian Contract Act lays down certain exceptions which make a promise without consideration valid and binding.

**Thus, an agreement without consideration is valid:**

If it is expressed in writing and registered and is made out of natural love and affection between parties standing in a near relation to each other; or

If it is made to compensate a person who has already done something voluntarily for the promisor, or done something which the promisor was legally compellable to do; or

If it is a promise in writing and signed by the person to be charged therewith, or by his agent, to pay a debt barred by the law of limitation

Besides, according to Section 185 of the Indian Contract Act, consideration is not required to create an agency

In the case of gift actually made, no consideration is necessary. There need not be nearness of relation and even if it is, there need not be any natural love and affection between them

The requirements in the above exceptions are noteworthy. The first one requires written and registered promise. The second may be oral or in writing and the third must be in writing.

### Illustrations

A, for natural love and affection, promises to give his son B ₹10,000. A put his promise to B into writing and registered it. This is a contract.

A registered agreement between a husband and his wife to pay his earnings to her is a valid contract, as it is in writing, is registered, is between parties standing in near relation, and is for love and affection (*Poonoo Bibi v. FyazBuksh*, (1874) 15 Bom L.R. 57).

But where a husband by a registered document, after referring to quarrels and disagreement between himself and his wife, promised to pay his wife a sum of money for her maintenance and separate residence, it was held that the promise was unenforceable, as it was not made for love and affection (*Rajluckhy Deb v. Bhootnath* (1900) 4 C.W.N. 488).

### Whether Gratuitous Promise can be Enforced

A gratuitous promise to subscribe to a charitable cause cannot be enforced, but if the promisee is put to some detriment as a result of his acting on the faith of the promise and the promisor knew the purpose and also knew that on the faith of the subscription an obligation might be incurred, the promisor would be bound by promise (*Kedar Nath v. Gorie Mohan* 64).

It may be noted that it is not necessary that the promisor should benefit by the consideration, it is sufficient if the promisee does some act from which a third person is benefited and he would not have done that act but for the promise of the promisor.

For example, Y requests X for loan, who agrees to give loan to Y if S gives guarantee of repayment of the loan. S gives such a guarantee of repayment by Y. Thereupon X gives loan to Y. Here S will be promisor and X the promisee, but from X's action, benefit is derived by Y and not by S. X would not have given the loan to Y had S not given the guarantee of repayment of loan. Thus, the benefit conferred on Y by X at the request of S is a sufficient consideration on the part of X as against the promise of S to repay the loan. Alternatively, it may be said that the detriment which X suffered by giving loan to Y at the request of S is sufficient consideration on the part of X in respect of the promise of S to repay the loan.

Consideration therefore, is some detriment to the promisee or some benefit to the promisor. Detriment to one person and benefit to the other are the same things looked from two angles. Ordinarily a promisor is not bound by his promise, unless some consideration is offered by the promisee.

### Terms Must be Certain

It follows from what has been explained in relation to offer, acceptance and consideration that to be binding, an agreement must result in a contract. That is to say, the parties must agree on the terms of their contract. They must make their intentions clear in their contract. The Court will not enforce a contract the terms of which are uncertain. Thus, an agreement to agree in the future (*a contract to make a contract*) will not constitute a binding contract e.g., a promise to pay an actress a salary to be "*mutually agreed between us*" is not a contract since the salary is not yet agreed: *Loftus v. Roberts* (1902).

Similarly, where the terms of a final agreement are too vague, the contract will fail for uncertainty. Hence, the terms must be definite or capable of being made definite without further agreement of the parties.

The legal maxim, therefore, is "*a contract to contract is not a contract*". If you agree "subject to contract" or "subject to agreement", the contract does not come into existence, for there is no definite or unqualified acceptance.

### Resume

Thus, a contract is always based upon:

- (i) Agreement (consensus ad idem) an unqualified acceptance of a definite offer;
- (ii) An intent to create legal obligations; and
- (iii) Consideration.

### FLAWS IN CONTRACT

There may be the circumstances under which a contract made under these rules may still be bad, because there is a flaw, vice or error somewhere. As a result of such a flaw, the apparent agreement is not a real agreement. Where there is no real agreement, the law has three remedies:

*Firstly:* The agreement may be treated as of no effect and it will then be known as void agreement.

*Secondly:* The law may give the party aggrieved the option of getting out of his bargain, and the contract is then known as voidable.

*Thirdly:* The party at fault may be compelled to pay damages to the other party.

#### (a) Void Agreement

A void agreement is one which is destitute of all legal effects. It cannot be enforced and confers no rights on either party. It is really not a contract at all, it is non-existent. Technically the words 'void contract' are a contradiction in terms. But the expression provides a useful label for describing the situation that arises when a 'contract' is claimed but in fact does not exist. For example, a minors contract is void.

#### (b) Voidable Contract

A voidable contract is one which a party can put to an end. He can exercise his option, if his consent was not free. The contract will, however be binding, if he does not exercise his option to avoid it within a reasonable time. The consent of a party is not free and so he is entitled to avoid the contract, if he has given his consent due to misrepresentation, fraud, coercion or undue influence.

### (c) Illegal Agreement

An illegal agreement is an unlawful agreement. The law prohibits agreements made with unlawful object or consideration. Such an agreement, like the void agreement has no legal effects as between the immediate parties. Further, transactions collateral to it also become tainted with illegality and are, therefore, not enforceable. Parties to an unlawful agreement cannot get any help from a Court of law, for no polluted hands shall touch the pure fountain of justice. On the other hand, a collateral transaction can be supported by a void agreement.

For example, one party may have deceived the other party, or in some other way there may be no genuine consent. The parties may be labouring under a mistake, or one or both the parties may be incapable of making a contract. Again, the agreement may be illegal or physically impossible. All these are called “the FLAWS in contract or the *VICES* of contract”.

**The chief flaws in contract are:**

Incapacity

Mistake

Misrepresentation

Fraud

Undue Influence

Coercion

Illegality

Impossibility

#### (i) Flaw in Capacity – Capacity and Persons

In law, persons are either natural or artificial. Natural persons are human beings and artificial persons are corporations. Contractual capacity or incapacity is an incident of personality.

The general rule is that all natural persons have full capacity to make binding contracts. But the Indian Contract Act, 1872 admits an exception in the case of:

- (i) minors,
- (ii) lunatics, and
- (iii) persons disqualified from contracting by any law to which they are subject.

These persons are not competent to contract. Section 11 provides that every “person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject”. A valid agreement requires that both the parties should understand the legal implications of their conduct. Thus, both must have a mature mind. The legal yardstick to measure maturity according to the law of contract is, that both should be major and of sound mind and if not, the law would presume that the maturity of their mind has not reached to the extent of visualising the pros and cons of their acts, hence, a bar on minors and lunatics competency to contract.

The contractual capacity of a corporation depends on the manner in which it was created.

#### Minor's Contract

According to the Indian Majority Act, 1875, a minor is a person, male or female, who has not completed the age of 18 years. In case a guardian has been appointed to the minor or where the minor is under the guardianship of the Court of Wards, the person continues to be a minor until he completes his age of 21 years. According to the Indian

Contract Act, no person is competent to enter into a contract who is not of the age of majority. It was finally laid down by the Privy Council in the leading case of *Mohori Bibi v. Dharmodas Ghose*, (1903) 30 Cal. 539, that a minor has no capacity to contract and minors contract is absolutely void. In this case, X, a minor borrowed Rs. 20,000 from Y, a money lender. As a security for the money advanced, X executed a mortgage in Y's favour. When sued by Y, the Court held that the contract by X was void and he cannot be compelled to repay the amount advanced by him.

Indian Courts have applied this decision to those cases where the minor has incurred any liability or where the liabilities on both sides are outstanding. In such cases, the minor is not liable. But if the minor has carried out his part of the contract, then, the Courts have held, that he can proceed against the other party. The rationale is to protect minors interest. According to the Transfer of Property Act, a minor cannot transfer property but he can be a transferee (person accepting a transfer). This statutory provision is an illustration of the above principle.

***The following points must be kept in mind with respect to minors contract:***

- (a) A minor's contract is altogether void in law, and a minor cannot bind himself by a contract. If the minor has obtained any benefit, such as money on a mortgage, he cannot be asked to repay, nor can his mortgaged property be made liable to pay.
- (b) Since the contract is void ab initio, it cannot be ratified by the minor on attaining the age of majority.
- (c) Estoppel is an important principle of the law of evidence. To explain, suppose X makes a statement to Y and intends that the latter should believe and act upon it. Later on, X cannot rescind from this statement and make a new one.

In other words, X will be estopped from denying his previous statement. But a minor can always plead minority and is not estopped from doing so even where he had produced a loan or entered into some other contract by falsely representing that he was of full age, when in reality he was a minor.

But where the loan was obtained by fraudulent representation by the minor or some property was sold by him and the transactions are set aside as being void, the Court may direct the minor to restore the property to the other party.

For example, a minor fraudulently overstates his age and takes delivery of a motor car after executing a promissory note in favour of the trader for its price. The minor cannot be compelled to pay the amount to the promissory note, but the Court on equitable grounds may order the minor to return the car to the trader, if it is still with the minor.

Thus, according to Section 33 of the Specific Relief Act, 1963 the Court may, if the minor has received any benefit under the agreement from the other party require him to restore, so far as may be such benefit to the other party, to the extent to which he or his estate has been benefited thereby.

- (d) A minors estate is liable to pay a reasonable price for necessaries supplied to him or to anyone whom the minor is bound to support (Section 68 of the Act).

The necessaries supplied must be according to the position and status in life of the minor and must be things which the minor actually needs. The following have also been held as necessaries in India.

Costs incurred in successfully defending a suit on behalf of a minor in which his property was in jeopardy; costs incurred in defending him in a prosecution; and money advanced to a Hindu minor to meet his marriage expenses have been held to be necessaries.

- (e) An agreement by a minor being void, the Court will never direct specific performance of the contract.
- (f) A minor can be an agent, but he cannot be a principal nor can he be a partner. He can, however, be admitted to the benefits of a partnership.
- (g) Since a minor is never personally liable, he cannot be adjudicated as an insolvent.
- (h) An agreement by a parent or guardian entered into on behalf of the minor is binding on him provided it is for his benefit or is for legal necessity. For, the guardian of a minor, may enter into contract for marriage on behalf of the minor, and such a contract would be good in law and an action for its breach would lie, if the contract is for the benefit of the minor (*Rose Fernandez v. Joseph Gonsalves*, 48 Bom. L. R. 673) e.g., if the parties are of the community among whom it is customary for parents to contract marriage for their children. The contract of apprenticeship is also binding.

However, it has been held that an agreement for service, entered into by a father on behalf of his daughter who is a minor, is not enforceable at law (*Raj Rani v. Prem Adib*, (1948) 51 Bom. L.R. 256).

### **Lunatics Agreement (Section 2)**

A person of unsound mind is a lunatic. That is to say for the purposes of making contract, a person is of unsound mind if at the time when he makes the contract, he is incapable of understanding it and of forming rational judgment as to its effect upon his interests.

A person of unsound mind cannot enter into a contract. A lunatics agreement is therefore void. But if he makes a contract when he is of sound mind, i.e., during lucid intervals, he will be bound by it.

A sane man who is delirious from fever, or who is so drunk that he cannot understand the terms of a contract, or form a rational judgement as to its effect on his interests cannot contract whilst such delirium or state of drunkenness lasts. A person under the influence of hypnotism is temporarily of unsound mind. Mental decay brought by old age or disease also comes within the definition.

Agreement by persons of unsound mind are void. But for necessaries supplied to a lunatic or to any member of his family, the lunatics estate, if any, will be liable. There is no personal liability incurred by the lunatic.

If a contract entered into by a lunatic or person of unsound mind is for his benefit, it can be enforced (for the benefit) against the other party but not vice-versa (*Jugal Kishore v. Cheddu*, (1903) 1 All. L.J. 43).

### **Persons Disqualified from Entering into Contract**

Some statutes disqualify certain persons governed by them, to enter into a contract. For example, Oudh Land Revenue Act provides that where a person in Oudh is declared as a 'disqualified proprietor under the Act, he is incompetent to alienate his property.

### **Alien Enemies**

A person who is not an Indian citizen is an alien. An alien may be either an alien friend or a foreigner whose sovereign or State is at peace with India, has usually contractual capacity of an Indian citizen. On the declaration of war between his country and India he becomes an alien enemy. A contract with an alien enemy becomes unenforceable on the outbreak of war.

For the purposes of civil rights, an Indian citizen of the subject of a neutral state who is *voluntarily* resident in hostile territory or is carrying on business there is an alien enemy. Trading with an alien enemy is considered illegal, being against public policy.

### **Foreign Sovereigns and Ambassadors**

Foreign sovereigns and accredited representatives of foreign states, i.e., Ambassadors, High Commissioners, enjoy a special privilege in that they cannot be sued in Indian Courts, unless they voluntarily submit to the jurisdiction of the Indian Courts. Foreign Sovereign Governments can enter into contracts through agents residing in India. In such cases the agent becomes personally responsible for the performance of the contracts.

### **Professional Persons**

In England, barristers-at law are prohibited by the etiquette of their profession from suing for their fees. So also are the Fellow and Members of the Royal College of Physicians and Surgeons. But they can sue and be sued for all claims other than their professional fees. In India, there is no such disability and a barrister, who is in the position of an advocate with liberty both to act and plead, has a right to contract and to sue for his fees (*Nihal Chand v. Dilawar Khan*, 1933 All. L.R. 417).

## Corporations

A corporation is an artificial person created by law, e.g., a company registered under the Companies Act, public bodies created by statute, such as Municipal Corporation of Delhi. A corporation exists only in contemplation of law and has no physical shape or form.

The Indian Contract Act does not speak about the capacity of a corporation to enter into a contract. But if properly incorporated, it has a right to enter into a contract. It can sue and can be sued in its own name. There are some contracts into which a corporation cannot enter without its seal, and others not at all. A company, for instance, cannot contract to marry. Further, its capacity and powers to contract are limited by its charter or memorandum of association. Any contract beyond such power is ultra vires and void.

## Married Women

In India there is no difference between a man and a woman regarding contractual capacity. A woman married or single can enter into contracts in the same ways as a man. She can deal with her property in any manner she likes, provided, of course, she is a major and is of sound mind.

Under the English law, before the passing of the Law Reform (Married Women and Tortfeasors) Act, 1935, a husband was responsible for his wife's contracts but since 1935 this liability no longer arises unless the wife is acting as the husband's agent. Now, therefore, even in England a married woman has full contractual capacity, and can sue and be sued in her own name.

## Flaw in Consent

The basis of a contract is agreement, i.e., mutual consent. In other words, the parties should mean the same thing in the same sense and agree voluntarily. It is when there is consent, that the parties are said to be *consensus ad idem* i.e. their minds have met. Not only consent is required but it must be a free consent. Consent is not free when it has been caused by coercion, undue influence, misrepresentation, fraud or mistake. These elements if present, may vitiate the contract.

When this consent is wanting, the contract may turn out to be void or voidable according to the nature of the flaw in consent. Where there is no consent, there can be no contract as in the case of mutual mistake. Where there is consent, but it is not free, a contract is generally voidable at the option of the party whose consent is not free. In the case of misrepresentation, fraud, coercion, undue influence, the consent of one of the parties is induced or caused by the supposed existence of a fact which did not exist.

### (ii) Mistake (Sections 20 and 21)

The law believes that contracts are made to be performed. The whole structure of business depends on this as the businessmen depend on the validity of contracts. Accordingly, the law says that it will not aid any one to evade consequences on the plea that he was mistaken.

On the other hand, the law also realises that mistakes do occur, and that these mistakes are so fundamental that there may be no contract at all. If the law recognises mistake in contract, the mistake will render the contract void.

## Effect of Mistake

A mistake in the nature of miscalculation or error of judgement by one or both the parties has no effect on the validity of the contract. For example, if A pays an excessive price for goods under a mistake as to their true value, the contract is binding on him (*Leaf v. International Galleries* (1950) 1 All E.R. 693).

Therefore, mistake must be a "vital operative mistake", i.e. it must be a mistake of fact which is fundamental to contract.

To be operative so as to render the contract void, the mistake must be:

- of fact, and not of law or opinion;

- (b) the fact must be essential to agreement, i.e., so fundamental as to negative the agreement; and
- (c) must be on the part of both the parties.

Thus, where both the parties to an agreement are under a mistake as to a matter of fact essential to agreement, the agreement is void (Section 20). Such a mistake prevents the formation of any contract at all and the Court will declare it void. For example, A agrees to buy from B a certain horse. It turns out that the horse was dead at the time of bargain though neither party was aware of the fact. The agreement is void.

### Mistake of Law and Mistake of Fact

Mistakes are of two kinds: (i) mistake of law, and (ii) mistake of fact. If there is a mistake of law of the land, the contract is binding because everyone is deemed to have knowledge of law of the land and ignorance of law is no excuse (*ignorantia juris non-excusat*).

But mistake of foreign law and mistake of private rights are treated as mistakes of fact and are excusable.

The law of a foreign country is to be proved in Indian Courts as ordinary facts. So mistake of foreign law makes the contract void. Similarly, if a contract is made in ignorance of private right of a party, it would be void, e.g., where A buys property which already belongs to him.

### Mutual or Unilateral Mistake

Mistake must be mutual or bilateral, i.e., it must be on the part of both parties. A unilateral mistake, i.e., mistake on the part of only one party, is generally of no effect unless (i) it concerns some fundamental fact and (ii) the other party is aware of the mistake. For this reason, error of judgement on the part of one of the parties has no effect and the contract will be valid.

### Mutual or Common Mistake as to Subject-matter

A contract is void when the parties to it assume that a certain state of things exist which does not actually exist or in their ignorance the contract means one thing to one and another thing to the other, and they contract subject to that assumption or under that ignorance. There is a mistake on the part of both the parties. Such a mistake may relate to the existence of the subject matter, its identity, quantity or quality.

- (a) **Mistake as to existence of the subject matter:** Where both parties believe the subject matter of the contract to be in existence but in fact, it is not in existence at the time of making the contract, there is mistake and the contract is void.

*In Couturier v. Hastie (1856)*, there was a contact to buy cargo described as shipped from port A to port B and believed to be at sea which in fact got lost earlier unknown to the parties and hence not in existence at the time of the contract. Held, the contract was void due to the parties mistake.

- (b) **Mistake as to identity of the subject matter:** Where the parties are not in agreement to the identity of the subject matter, i.e., one means one thing and the other means another thing, the contract is void; there is no *consensus ad idem*.

*In Raffles v. Wichelhaks (1864)*, A agreed to buy from B a cargo of cotton to arrive "ex Peerless from Bombay". There were two ships called "Peerless" sailing from Bombay, one arriving in October and the other in December. A meant the earlier ship and B the latter. Held, the contract was void for mistake.

- (c) **Mistake as to quantity of the subject matter:** There may be a mistake as to quantity or extent of the subject matter which will render the contract void even if the mistake was caused by the negligence of a third-party.

*In Henkel v. Pape (1870)*, P wrote to H inquiring the price of rifles and suggested that he might buy as many as fifty. On receipt of a reply he wired send three rifles. Due to the mistake of the telegraph clerk the message transmitted to H was send the rifles. H despatched 50 rifles. Held, there was no contract between the parties.

- (d) **Mistake as to quality of the subject-matter or promise:** Mistake as to quality raises difficult questions. If the mistake is on the part of both the parties the contract is void. But if the mistake is only on the part of one party difficulty arises.

The general rule is that a party to a contract does not owe any duty to the other party to disclose all the facts in his possession during negotiations. Even if he knows that the other party is ignorant of or under some misapprehension as to an important fact, he is under no obligation to enlighten him. Each party must protect his own interests unaided. In contract of sale of goods, this rule is summed up in the maxim *caveat emptor* (Let the buyer beware.) The seller is under no duty to reveal the defects of his goods to the buyer, subject to certain conditions.

### Unilateral Mistake as to Nature of the Contract

The general rule is that a person who signs an instrument is bound by its terms even if he has not read it. But a person who signs a document under a fundamental mistake as to its nature (not merely as to its contents) may have it avoided provided the mistake was due to either-

- (a) the blindness, illiteracy, or senility of the person signing, or
- (b) a trick or fraudulent misrepresentation as to the nature of the document.

### Unilateral Mistake as to the Identity of the Person Contracted With

It is a rule of law that if a person intends to contract with A, B cannot give himself any right under it. Hence, when a contract is made in which personalities of the contracting parties are or may be of importance, no other person can interpose and adopt the contract. For example, where M intends to contract only with A but enters into contract with B believing him to be A, the contract is vitiated by mistake as there is no *consensus ad idem*.

Mistake as to the identity of the person with whom the contract is made will operate to nullify the contract only if:

- (i) the identity is of material importance to the contracts; and
- (ii) the mistake is known to the other person, i.e., he knows that it is not intended that he should become a party to the contract.

In *Cundy vs. Lindsay* [(1878) 3 A.C. 459], one Blenkarn posing as a reputed trader Blankiron, placed an order for some goods with M/s Lindsay and Co. The company, thought that it is dealing with Blankiron and supplied the goods. Blenkarn sold the goods to Cundy and did not pay to Lindsay. The latter sued Cundy. The Court held that there was no contract between Lindsay and Blenkarn and therefore Cundy has no title to the goods.

### (iii) Misrepresentation (Section 18)

The term "misrepresentation" is ordinarily used to connote both "innocent misrepresentation" and "dishonest misrepresentation". Misrepresentation may, therefore, be either (i) Innocent misrepresentation, or (ii) Wilful misrepresentation with *intent to deceive* and is called fraud.

#### Innocent Misrepresentation

If a person makes a representation believing what he says is true he commits innocent misrepresentation. Thus, any false representation, which is made with an honest belief in its truth is innocent. The effect of innocent misrepresentation is that the party misled by it can avoid the contract, but cannot sue for damages in the normal circumstances.

**But in order to avoid a contract on the ground of misrepresentation, it is necessary to prove that:**

- (i) there was a representation or assertion,
- (ii) such assertion induced the party aggrieved to enter into the contract.
- (iii) the assertion related to a matter of fact ( and not of law as ignorance of law is no excuse).
- (iv) the statement was not a mere opinion or hearsay, or commendation (i.e., reasonable praise). For example an advertisement saying, "washes whiter than the whitest".
- (v) the statement which has become or turned out to be untrue, was made with an honest belief in its truth.

### **Damages for Innocent Misrepresentation**

Generally the injured party can only avoid the contract and cannot get damages for innocent misrepresentation. But in the following cases, damages are obtainable:

- (i) From a promoter or director who makes innocent misrepresentation in a company prospectus inviting the public to subscribe for the shares in the company;
- (ii) Against an agent who commits a breach of warranty of authority;
- (iii) From a person who (at the Courts discretion) is estopped from denying a statement he has made where he made a positive statement intending that it should be relied upon and the innocent party did rely upon it and thereby suffered damages;
- (iv) Negligent representation made by one person to another between whom a confidential relationship, like that of a solicitor and client exists.

### **(iv) Wilful Misrepresentation or Fraud (Section 17)**

Fraud is an untrue statement made knowingly or without belief in its truth or recklessly, carelessly, whether it be true or false with the intent to deceive. The chief ingredients of a fraud are:

- (i) a false representation or assertion;
- (ii) of fact (and not a mere opinion),
- (iii) made with the intention that it should be acted upon,
- (iv) the representation must have actually induced the other party to enter into the contract and so deceived him,
- (v) the party deceived must thereby be indemnified, for there is no fraud without damages, and
- (vi) the statement must have been made either with the knowledge that it was false or without belief in its truth or recklessly without caring whether it was true or false.

It is immaterial whether the representation takes effect by false statement or with concealment. The party defrauded can avoid the contract and also claim damages.

Mere silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud, unless silence is in itself equivalent to speech, or where it is the duty of the person keeping silent to speak as in the cases of contracts *uberrimae fidei*- (contracts requiring utmost good faith).

### **Contracts Uberrimae Fidei**

There are contracts in which the law imposes a special duty to act with the utmost good faith i.e., to disclose all material information. Failure to disclose such information will render the contract voidable at the option of the other party.

### **Contracts uberrimae fidei are:**

- (a) Contract of insurance of all kinds: The assured must disclose to the insurer all material facts and whatever he states must be correct and truthful.

- (b) Company prospectus: When a company invites the public to subscribe for its shares, it is under statutory obligation to disclose truthfully the various matters set out in the Companies Act. Any person responsible for non-disclosure of any of these matters is liable to damages. Also, the contract to buy shares is voidable where there is a material false statement or non-disclosure in the prospectus.
- (c) Contract for the sale of land: The vendor is under a duty to the purchaser to show good title to the land he has contracted to sell.
- (d) Contracts of family arrangements: When the members of a family make agreements or arrangements for the settlement of family property, each member of the family must make full disclosure of every material fact within his knowledge.

#### **Difference between Fraud and Innocent Misrepresentation**

1. Fraud implies an intent to deceive, which is lacking if it is innocent misrepresentation.
2. In case of misrepresentation and fraudulent silence, the defendant can take a good plea that the plaintiff had the means of discovering the truth with ordinary diligence. This argument is not available if there is fraud (Section 19- exception).
3. In misrepresentation the plaintiff can avoid or rescind the contract. In fraud, the plaintiff can claim damages as well.
4. If there is fraud, it may lead to prosecution for an offence of cheating under the Indian Penal Code.

#### **(v) Coercion**

Coercion as defined in Section 15 means “the committing or threatening to commit any act forbidden by the Indian Penal Code, or unlawful detaining or threatening to detain, any property to the prejudice of any person whatever with the intention of causing any person to enter into an agreement”. Simply stated, the doing of any act forbidden by the Indian Penal Code is coercion even though such an act is done in a place where the Indian Penal Code is not in force. If A at the point of a pistol asks B to execute a promissory note in his favour and B to save his life does so he can avoid this agreement as his consent was not free. Even a threat to third-party, e.g., where A compels B to sign a document threatening to harm C, in case B does not sign would also amount to coercion.

It has been held that mere threat by one person to another to prosecute him does not amount to coercion. There must be a contract made under the threat and that contract should be one sought to be avoided because of coercion (*Ramchandra v. Bank of Kohlapur*, 1952 Bom. 715). It may be pointed out that coercion may proceed from any person and may be directed against any person, even a stranger and also against goods, e.g., by unlawful detention of goods.

#### **(vi) Undue Influence**

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

The elements of undue influence are (i) a dominant position, and (ii) the use of it to obtain an unfair advantage. The words “unfair advantage” do not limit the jurisdiction to cases where the transaction would be obviously unfair as between persons dealing on an equal footing. In the words of Lord Kingston, “the principle applies to every case where influence is acquired and abused where confidence is reposed and betrayed”.

Sub-section (2) of Section 16 provides that a person is deemed to be in a position to dominate the will of another—

- (a) Where he holds a real or apparent authority over the other or where he stands in a fiduciary relation to the other, e.g., minor and guardian; trustee and beneficiary; solicitor and client. There is, however, no presumption of undue influence in the relation of creditor and debtor, husband and wife (unless the wife is a parda-nishin woman) and landlord and tenant. In these cases the party has to prove that undue influence has been exercised on him, there being no presumption as to existence of undue influence.

- (b) Where he makes a contract with a person whose mental capacity is temporarily or permanently affected by reason of age, illness or mental or bodily distress e.g., doctor and patient.

### Illustration

A, having advanced money to his son B, during his minority, upon B's coming of age obtains, by misuse of parental influence a bond upon B for a greater amount than the sum due in respect of the advance. A employs undue influence.

A, a man enfeebled by disease or age is induced by B's influence over him as his medical attendant, to agree to pay B an unreasonable sum for his professional services. B employs undue influence.

A parent stands in a fiduciary relation towards his child and any transaction between them by which any benefit is procured by the parent to himself or to a third party, at the expense of the child will be viewed with jealousy by Courts of Equity and the burden will be on the parent or third-party claiming the benefit of showing that the child while entering into the transaction had independent advice, that he thoroughly understood the nature of transaction and that he was removed from all undue influence when the gift was made (*Marim Bibi v. Cassim Ibrahim* (1939) 184 I.C. 171 (1939) A.I.R. 278).

Where there is a presumption of undue influence, the presumption can be rebutted by showing that

- (i) full disclosure of all material facts was made,
- (ii) the consideration was adequate, and
- (iii) the weaker party was in receipt of independent legal advice.

### Transaction with parda-nishin women

The expression 'parda-nishin' denotes complete seclusion. Thus, a woman who goes to a Court and gives evidence, who fixes rents with tenants and collects rents, who communicates when necessary, in matters of business, with men other than members of her own family, could not be regarded as a parda-nishin woman (*Ismail Musafee v. Hafiz Boo* (1906) 33 Cal. LR 773 and 33 I.A. 86). The principles to be applied to transactions with parda-nishin woman are founded on *equity and good conscience* and accordingly a person who contracts with parda-nishin woman has to prove that no undue influence was used and that she had free and independent advice, fully understood the contents of the contract and exercised her free will. "The law throws around her a special cloak of protection" (*Kali Baksh v. Ram Gopal* (1914) L.R. 41 I.A. 23, 28-29, 36 All 81, 89).

*Unconscionable transactions:* An unconscionable transaction is one which makes an exorbitant profit of the others distress by a person who is in a dominant position. Merely the fact that the rate of interest is very high in a money lending transaction shall not make it unconscionable. But if the rate of interest is very exorbitant and the Court regards the transaction unconscionable, the burden of proving that no undue influence was exercised lies on the creditor. It has been held that urgent need of money on the part of the borrower does not itself place the lender in a position to dominate his will within the meaning of this Section (*Sunder Koerv. Rai Sham Krishen* (1907) 34 Cal. 150, C.R. 34 I.A. 9).

### (vii) Legality of Object

One of the requisites of a valid contract is that the object should be lawful. Section 10 of the Indian Contract Act, 1872, provides, "All agreements are contracts if they are made by free consent of parties competent to contract for a lawful consideration and with a lawful object..." Therefore, it follows that where the consideration or object for which an agreement is made is unlawful, it is not a contract.

Section 23 of the Indian Contract Act, 1872 provides that the consideration or object of an agreement is

- (i) lawful unless it is forbidden by law; or
- (ii) it is of such nature that if permitted it would defeat the provisions of law; or
- (iii) is fraudulent; or
- (iv) involves or implies injury to the person or property of another; or
- (v) the Court regards it an immoral or opposed to public policy.

In each of these cases the consideration or object of an agreement is said to be unlawful. *Every agreement of which the object or consideration is unlawful is void.*

### Illustration

- (i) X, Y and Z enter into an agreement for the division among them of gains acquired by them by fraud. The agreement is void as its object is unlawful.
- (ii) X promises to obtain for Y an employment in the Government service and Y promises to pay Rs. 1,500 to X. The agreement is void, as the consideration for it is unlawful.
- (iii) X promises to Y to drop a prosecution which he has instituted against Y for robbery, and Y promises to restore the value of the things taken. The agreement is void as its object is unlawful.
- (iv) A who is B's mukhtr promises to exercise his influence, as such, with B in favour of C and C promises to pay Rs. 1,000 to A. The agreement is void because it is immoral.
- (v) An agreement by the proprietors of a newspaper to indemnify the printers against claims arising from libels printed in the newspaper is void as it implies or involves injury to the person of another.

### Void and Illegal Contracts

A void contract is one which is destitute of legal effects altogether. An illegal contract too has no legal effect as between the immediate parties to the contract, but has the further effect of tainting the collateral contracts also with illegality. For instance A borrows from B Rs. 1,000 for lending to C a minor. The contract between A and C is void, but B can nevertheless recover the money from A. On the other hand, if A had borrowed Rs. 1,000 from B to buy a pistol to shoot C, the question whether B can recover the money hinges on whether B was aware of the purpose for which money was borrowed. If B had knowledge of the illegal purpose, he cannot recover. Therefore, it may be said that *all illegal agreements are void but all void agreements are not necessarily illegal.*

### Consequence of Illegal Agreements

- (i) an illegal agreement is entirely void;
- (ii) no action can be brought by a party to an illegal agreement. The maxim is "Ex turpi cause non-origitur action" - from an evil cause, no action arises;
- (iii) money paid or property transferred under an illegal agreement cannot be recovered. The maxim is in pari delicto poterest condition defendentes- In cases of equal guilt, more powerful is the condition of the defendant;
- (iv) where an agreement consists of two parts, one part legal and other illegal, and the legal parts are separable from the illegal one, then the Court will enforce the legal one. If the legal and the illegal parts cannot be separated the whole agreement is illegal; and
- (v) any agreement which is collateral to an illegal agreement is also tainted with illegality and is treated as being illegal, even though it would have been lawful by itself (*Film Pratapchand v. Firm Kotri Re. AIR (1975) S.C. 1223*).

### Exception to General Rule of no Recovery of Money or Property

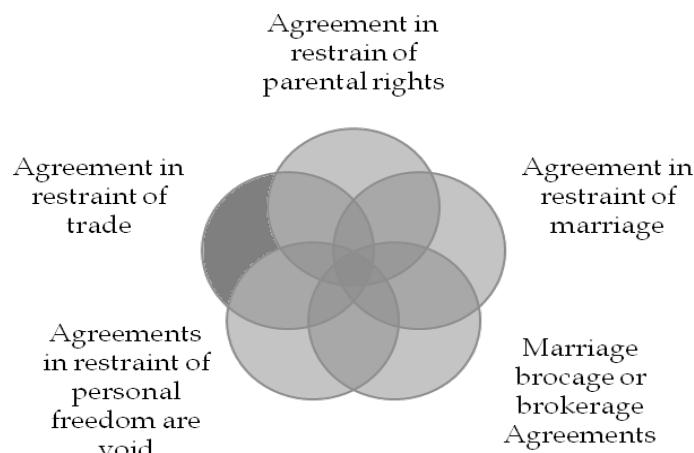
In the following cases, a party to an illegal agreement may sue to recover money paid or property transferred:

- (a) Where the transfer is not in pari delicto (equally guilty) with the defendant, i.e. the transferee. For example, where A is induced to enter into an illegal agreement by the fraud of B, A may recover the money paid if he did not know that the contract was illegal.
- (b) If the plaintiff can frame a cause of action entirely dependent of the contract.
- (c) Where a substantial part of the illegal transaction has not been carried out and the plaintiff is truly and genuinely repentant. (*Bigos v. Bonstead (1951), All E.R. 92*).

## Agreements Void as being Opposed to Public Policy

The head public policy covers a wide range of topics. Agreements may offend public policy by tending to the prejudice of the State in times of war, by tending to the abuse of justice or by trying to impose unreasonable and inconvenient restrictions on the free choice of individuals in marriage, or their liberty to exercise lawful trade or calling. The doctrine of public policy is a branch of Common Law and like any other branch of Common Law it is governed by the precedents [*Gherulal Parakh v. Mahadeodas Maiya* (1959) 2 S.C.R. (Suppl.) 406; AIR 1959 S.C. 781]. The doctrine of public policy is not to be extended beyond the classes of cases already covered by it and no Court can invent a new head of public policy [*Lord Halsbury, Janson v. Driefontien Consolidated Mines* (1902) A.C. 484, 491]. It has been said by the House of Lords that public policy is always an unsafe and treacherous ground for legal decisions. Even if it is possible for Courts to evolve a new head of public policy, it should be done under extraordinary circumstances giving rise to incontestable harm to the society.

***The following agreements are void as being against public policy but they are not illegal:***



- (a) Agreement in restraint of parental rights: An agreement by which a party deprives himself of the custody of his child is void.
- (b) Agreement in restraint of marriage: An agreement not to marry at all or not to marry any particular person or class of persons is void as it is in restraint of marriage.
- (c) Marriage brokerage or brokerage Agreements: An agreement to procure marriage for reward is void. Where a purohit (priest) was promised Rs. 200 in consideration of procuring a wife for the defendant, the promise was held void as opposed to public policy, and the purohit could not recover the promised sum.
- (d) Agreements in restraint of personal freedom are void: Where a man agreed with his money lender not to change his residence, or his employment or to part with any of his property or to incur any obligation on credit without the consent of the money lender, it was held that the agreement was void.
- (e) Agreement in restraint of trade: An agreement in restraint of trade is one which seeks to restrict a person from freely exercising his trade or profession.

### AGREEMENTS IN RESTRAINT OF TRADE VOID

Section 27 of the Indian Contract Act states that every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is, to that extent, void.

This Section is not happily worded and has been criticised by many authors. It appears from the wording that every kind of restraint, whether total or partial falls within the prohibition of this Section. In English law the Courts have held that if a restraint is reasonable, it will be valid. Leading case on this point is *Nordenfelt v. Maxim Nordenfelt Guns Co.*, (1894) A.C. 535. N was an inventor and a manufacturer of guns and ammunition. He sold his world-wide business to M and promised not to manufacture guns anywhere in the world for 25 years. The House of Lords held

that the restraint was reasonable as it was no more than is necessary for the protection of the company, the contract was binding. Whether a restraint is reasonable or not depends upon the facts of each case.

Our courts are not consistent on the point whether reasonable restraints are permitted or not. In *Madhub Chunder v. RaCoomar*(1874) 14 Bang. L.R. 76, A paid Rs. 900 to B's workman. B undertook to stop his business in a particular locality in Calcutta. He did not keep his promise. A's suit for the sum was dismissed since the agreement was void under Section 27. The reasonableness or otherwise of the restraint was not discussed. However, if a restrictive meaning is adopted, most of the ordinary mercantile agreements may be hit. Thus, the Courts have held that if the restraint is one which is really necessary for the carrying on business, the same is not prohibited. In *Mackenzie v. Sitarmiah*, (1891) 15 Mad. 79, A agreed to sell to B all the salt he manufactured and B agreed to buy such salt. A further agreed not to sell salt to third-parties. The Court held that the agreement was valid.

Other type of restraints is personal covenants between an employer and his employee whereby the latter agrees not to compete with the former or serve with any of his competitors after employment. This issue came before the Supreme Court in *Niranjan Shanker Golikari v. The Century Spinning and Manufacturing Co. Ltd.*, AIR 1967 S.C. 1098. In this case N entered into a bond with the company to serve for a period of five years. In case, N leaves his job earlier and joins elsewhere with company's competitor within five years, he was liable for damages. N was imparted the necessary training but he left the job and joined another company. The former employer instituted a suit against N. The Supreme Court, held that the restraint was necessary for the protection of the company's interests and not such as the Court would refuse to enforce.

In other case, it has been reiterated that the restriction should be reasonable taking into account the facts and circumstances of the case. In *Superintendence Company of India Ltd. v. Krishna Murgai* [(1981) 2 SCC 246], the Supreme Court laid down that a restraint beyond the term of service would be void and the only ground on which it can be justified is by showing it is necessary for the protection of the employer's goodwill.

The words "to the extent" in Section 27 make it clear that if in an agreement there are some covenants which are prohibited whereas the others are not and if the two parts can be separated then only those covenants which operate as restraint of trade would be void and not whole of the agreement itself. To illustrate, in *Brahmaputra Tea Co. Ltd. v. Scarth*(1885) I.L.R. Cal. 545, the employee agreed with the employer firstly, not to compete with latter after leaving the job and, secondly, not to injure employer's interest during employment. The Court held that the first condition is a restraint of trade but the second is binding.

### When Contracts in Restraint of Trade Valid

*Prima facie* every restraint of trade is void, but certain exceptions to this general rule are recognised. If a partial and reasonable restraint falls under any of the following exceptions, the contract will be enforceable:

- Sale of goodwill: Where the seller of the goodwill of a business undertakes not to compete with the purchaser of the goodwill, the contract is enforceable provided the restraint appears to be reasonable as to territorial limits and the length of time.
- Partners agreements: Section 11(2) of the Indian Partnership Act permits contracts between partners to provide that a partner shall not carry on any business other than that of the firm while he is a partner.
- Section 36(2) and Section 54 of the Indian Partnership Act provide that a partner may make an agreement with his partners that on ceasing to be a partner he will not carry on any business similar to that of the firm within specified period or within specified limits. The agreement shall be binding if the restrictions are reasonable.

*Trade Combinations:* An agreement, the object of which is to regulate business and not to restrain it is valid. Thus, an agreement in the nature of a business combination between traders or manufacturers e.g. not to sell their goods below a certain price, to pool profits or output and to divide the same in an agreed proportion does not amount to a restraint of trade and is perfectly valid (*Fraster & Co. v. Laxmi Narain*, (1931) 63 All 316).

*Negative stipulations in service agreements:* An agreement of service by which a person binds himself during the term of the agreement not to take service with anyone else is not in restraint of lawful profession and is valid.

## WAGERING AGREEMENTS

The literal meaning of the word “wager” is a “bet”. Wagering agreements are nothing but ordinary betting agreements. For example, A and B enter into an agreement that if England’s Cricket Team wins the test match, A will pay B Rs. 100 and if it loses B will pay Rs. 100 to A. This is a wagering agreement and nothing can be recovered by winning party under the agreement.

The essence of gaming and wagering is that one party is to win and the other to lose upon a future event which at the time of the contract is of an uncertain nature that is to say, if the event turns out one way A will lose; but if it turns out the other way he will win (*Thacker v. Hardy*, (1878) 4 OBD 685).

### Wagering Agreements Void

In India except Mumbai, wagering agreements are void. In Mumbai, wagering agreements have been declared illegal by the Avoiding Wagers (Amendment) Act, 1865. Therefore, in Mumbai a wagering agreement being illegal, is void not only between the immediate parties, but taints and renders void all collateral agreements to it.

Thus, A bets with B and losses, applies to C for a loan, who pays B in settlement of A’s losses. C cannot recover from A because this is money paid “under” or “in respect of” a wagering transaction which is illegal in Mumbai. But in respect of India such a transaction (i.e., betting) being only void, C could recover from A. Of course, if A refused to pay B the amount of the bet that he has lost, B could not sue A anywhere. Again, where an agent bets on behalf of his principal and loses and pays over the money to the winner, he cannot recover the money from his principal, if the transactions took place in Mumbai, but elsewhere he could recover. But if the agent wins, he must pay the winnings to the principal, as this money was received on behalf of the principal.

Sometimes, commercial transactions assume the form of wagering contracts. The sample test to find out whether a particular transaction is a wager or a genuine commercial transaction is: “Where delivery of the goods sold is intended to be given and taken, it is valid contract, but where only the differences are intended to be paid, it will be a wagering contract and unenforceable”.

In a wagering contract there must be mutuality in the sense that the gain of one party should be loss to the other on the happening of an uncertain event which is the subject matter of the contract.

## VOID AGREEMENTS

***The following types of agreements are void under Indian Contract Act:***

- (a) Agreement by or with a minor or a person of unsound mind or a person disqualified to enter into a contract - Section 11;
- (b) Agreement made under a mistake of fact, material to the agreement on the part of the both the parties - Section 20.
- (c) An agreement of which the consideration or object is unlawful - Section 23.
- (d) If any part of a single consideration for one or more objects, or any one or any part of any one of several considerations for a single object, is unlawful, the agreement is void - Section 24.
- (e) An agreement made without consideration subject to three exceptions provided to Section 25.
- (f) An agreement in restraint of marriage - Section 26.
- (g) An agreement in restraint of trade - Section 27.
- (h) An agreement in restraint of legal proceedings - Section 28.
- (i) Agreements, the meaning of which is not certain, or capable of being made certain - Section 29.
- (j) Agreement by way of wager - Section 30.
- (k) An agreement to enter into an agreement in the future.
- (l) An agreement to do an act impossible in itself - Section 56(1)

## When contract becomes void

An agreement not enforceable by law is void *ab initio* - Section 2(g).

A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable - Section 2(j) A contract becomes void when, by reason of some event which the promisor could not prevent, the performance of the contract becomes impossible, e.g., by destruction of the subject- matter of the contract after the formation of the contract.

A contract becomes void by reason of subsequent illegality. A in India agrees to supply goods to B in Pakistan. After the formation of the contract war breaks out between India and Pakistan and the supply of goods to Pakistan is prohibited by legislation. The contract becomes void.

A contingent contract to do or not do to anything if an uncertain future event happens becomes void if the event becomes impossible.

Where a contract is voidable at the option of the aggrieved party, the contract becomes void when the option is exercised by him.

## RESTITUTION

When a contract becomes void, it is not to be performed by either party. But if any party has received any benefit under such a contract from the other party he must restore it or make compensation for it to the other party. A agrees to sell to B after 6 months a certain quantity of gold and receives Rs. `500 as advance. Soon after the agreement, private sales of gold are prohibited by law. The contract becomes void and A must return the sum of Rs. 500 to B.

Restitution is also provided for by Section 65 where an agreement is discovered to be void. A pays Rs. `500 in consideration of B's promising to marry, C, A's daughter C is dead at the time of the promise. The agreement is discovered to be void and B must pay back Rs. 500.

But there is no resolution where the parties are wholly incompetent to contract, e.g., where one of the parties is a minor. The minor cannot be asked to restore the benefit, e.g., a minor borrowed Rs. `1,000 from B, he cannot be asked to pay back Rs. `1,000 to B because the contract is void (*Mohori Bibis* case).

## CONTINGENT CONTRACT (SECTION 31)

As per Section 31, a contingent contract is a contract to do or not to do something, if some event *collateral to such contract*, does or does not happen. For example, A contracts to sell B 10 bales of cotton for Rs. 20,000, if the ship by which they are coming returns safely. This is a contingent contract.

Contract of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.

## Rules regarding contingent contracts

The following rules are contained in Section 32-36:

- (a) Contracts contingent upon the happening of a future uncertain event cannot be enforced by law unless and until that event has happened. If the event becomes impossible, the contract becomes void - Section 32.
  - (i) A makes a contract to buy B's house if A survives C. This contract cannot be enforced by law unless and until C dies in A's lifetime.
  - (ii) A contracts to pay B a sum of money when B marries C, C dies without being married to B. The contract becomes void.
- (b) Contracts contingent upon the non-happening of an uncertain future event can be enforced when the happening of that event becomes impossible and not before - Section 33.

A contracts to pay B a certain sum of money if a certain ship does not return. The ship is sunk. The contract can be enforced when the ship sinks.

- (c) If a contract is contingent upon how a person will act at an unspecified time, the event shall be considered to become impossible when such person does anything which renders it impossible that he should so act within any definite time or otherwise than under further contingencies - Section 34.  
 A agrees to pay B Rs. 1,000 if B marries C. C marries D. The marriage of B to C must now be considered impossible although it is possible that D may die and C may afterwards marry B.
- (d) Contracts contingent on the happening of an event within a fixed time become void if, at the expiration of the time, such event has not happened, or if, before the time fixed, such event becomes impossible - Section 35.  
 A promises to pay B a sum of money if a certain ship returns within a year. The contract may be enforced if the ship returns within the year, and becomes void if the ship is burnt within the year.
- (e) Contracts contingent upon the non-happening of an event within a fixed time may be enforced by law when the time fixed has expired and such event has not happened or before the time fixed has expired, if it becomes certain that such event will not happen - Section 35.  
 A promises to pay B a sum of money if a certain ship does not return within the year. The contract may be enforced if the ship does not return within the year or is burnt within the year.
- (f) Contingent agreements to do or not to do anything if an impossible event happens, are void, whether the impossibility of the event is known or not known to the parties to the agreement at the time when it is made - Section 36.  
 A agrees to pay Rs. 1,000 to B if two straight lines should enclose a space. The agreement is void.

## CERTAIN RELATIONS RESEMBLING THOSE OF CONTRACT (QUASI CONTRACTS)

### Nature of Quasi-Contracts

A valid contract must contain certain essential elements, such as offer and acceptance, capacity to contract, consideration and free consent. But sometimes the law implies a promise imposing obligations on one party and conferring right in favour of the other even when there is no offer, no acceptance, no *consensus ad idem*, and in fact, there is neither agreement nor promise. Such cases are not contracts in the strict sense, but the Court recognises them as relations resembling those of contracts and enforces them as if they were contracts, hence the term quasi-contracts (i.e., resembling a contract).

A quasi-contract rests on the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth, it is not a contract at all. It is an obligation which the law creates, in the absence of any agreement, when any person is in the possession of other persons money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which in justice and fairness belongs to another. It is the duty and not an agreement or intention which defines it. A very simple illustration is money paid under mistake. Equity demands that such money must be paid back.

### Quasi-Contracts or Implied Contracts under the Indian Contract Act

The following types of quasi-contracts have been dealt within the Indian Contract Act—

- (a) Necessaries supplied to person incapable of contracting or to anyone whom he is illegally bound to support - Section 68.
- (b) Suit for money had and received - Section 69 and 72.
- (c) Quantum Meruit
- (d) Obligations of a finder of goods - Section 71.
- (e) Obligation of person enjoying benefit of a non-gratuitous act - Section 70

### Necessaries

Contracts by minors and persons of unsound mind are void. However, Section 68 of the Indian Contract Act provides that their estates are liable to reimburse the trader, who supplies them with necessities of life.

## Suit for money had and received

The right to file a suit for the recovery of money may arise

- (a) Where the plaintiff paid money to the defendant (i) under a mistake, (ii) in pursuance of a contract the consideration for which has failed, or (iii) under coercion, oppression, extortion or other such means.  
A debtor may recover, from a creditor the amount of an over-payment made to him by mistake. The mistake may be mistake of fact or a mistake of law.
- (b) Payment to third-party of money which another is bound to pay. For example, where A's goods are wrongfully attached in order to realise arrears of Government revenue due by B, and A pays the amount to save his goods from being sold, he is entitled to recover the amount from B.
- (c) Money obtained by defendant from third-parties. For example, where an agent has obtained a secret commission or a fraudulent payment from a third-party, the principle can recover the amount from the agent.

## Quantum Meruit

The expression "*Quantum Meruit*" literally means "as much as earned" or reasonable remuneration. It is used where a person claims reasonable remuneration for the services rendered by him when there was no express promise to pay the definite remuneration. Thus, the law implies reasonable compensation for the services rendered by a party if there are circumstances showing that these are to be paid for.

The general rule is that where a party to a contract has not fully performed what the contract demands as a condition of payment, he cannot sue for payment for that which he has done. The contract has to be indivisible and the payment can be demanded only on the completion of the contract.

But where one party who has performed part of his contract is prevented by the other from completing it, he may sue on a *quantum meruit*, for the value of what he has done.

The claim on a *quantum meruit* arises when one party abandons the contract, or accepts the work done by another under a void contract.

The party in default may also sue on a "*quantum meruit*" for what he has done if the contract is divisible and the other party has had the benefit of the part which has been performed. But if the contract is not divisible, the party at fault cannot claim the value of what he has done.

## Obligations of finder of lost goods

The liability of a finder of goods belonging to someone else is that of a bailee. This means that he must take as much care of the goods as a man of ordinary prudence would take of his own goods of the same kind. So far as the real owner of the goods is concerned, the finder is only a bailee and must not appropriate the goods to his own use. If the owner is traced, he must return the goods to him. The finder is entitled to get the reward that may have been offered by the owner and also any expenses he may have incurred in protecting and preserving the property.

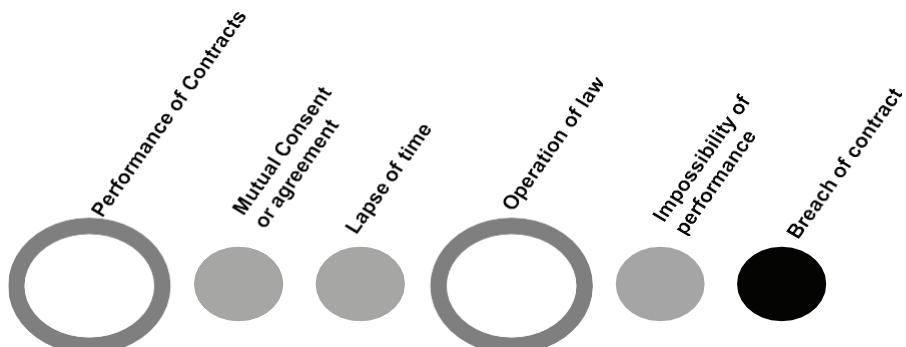
## Obligation of a person enjoying benefit of non-gratuitous act

Section 70 of the Indian Contract Act provides that where a person lawfully does something for another person or delivers anything to him without any intention of doing so gratuitously and the other person accepts and enjoys the benefit thereof, the latter must compensate the former or restore to him the thing so delivered. For example, when one of the two joint tenants pays the whole rent to the landlord, he is entitled to compensation from his co-tenant, or if A, a tradesmen, leaves goods at B's house by mistake and B treats the goods as his own, he is bound to pay A for them.

## DISCHARGE OR TERMINATION OF CONTRACTS

A contract is said to be discharged or terminated when the rights and obligations arising out of a contract are extinguished.

**Contracts may be discharged or terminated by any of the following modes:**



### (a) Performance of Contracts (Section 37)

Section 37 of the Act provides that the parties to a contract must either perform or offer to perform their respective promises, unless such performance is dispensed with or excused under the provision of the Indian Contract Act, or any other law. In case of death of the promisor before performance, the representatives of the promisor are bound to perform the promise *unless a contrary intention appears from the contract*.

#### Illustration

X promises to deliver a horse to Y on a certain day on payment of Rs 1,000. X dies before that day. X's representatives are bound to deliver the horse to Y and Y is bound to pay Rs. 1,000 to X's representatives.

### Tender of Performance (Section 38)

In case of some contracts, it is sometimes sufficient if the promisor performs his side of the contract. Then, if the performance is rejected, the promisor is discharged from further liability and may sue for the breach of contract if he so wishes. This is called discharge by tender.

To be valid, a tender must fulfil the following conditions

- it must be unconditional;
- it must be made at a proper time and place;
- it must be made under circumstances enabling the other party to ascertain that the party by whom it is made is able and willing then and there to do the whole of what he is bound, to do by his promise;
- if the tender relates to delivery of goods, the promisee must have a reasonable opportunity of seeing that the thing offered is the thing which the promisor is bound by his promise to deliver;
- tender made to one of the several joint promisees has the same effect as a tender to all of them.

#### Who can demand performance?

Generally speaking, a stranger to contract cannot sue and the person who can demand performance is the party to whom the promise is made. But an assignee of the rights and benefits under a contract may demand performance by the promisor, in the same way as the assignor, (i.e., the promisee) could have demanded.

#### Effect of refusal of party to perform wholly

Section 39 provides that when a party to a contract has refused to perform or disabled himself from performing his promise in its entirety, the promisee may put an end to the contract unless he had signified by words or conduct his acquiescence in its continuance.

### Illustration

- (a) X, a singer enters into a contract with Y, the manager of a theatre to sing at his theatres two nights in every week during the next two months, and Y engaged to pay her Rs. 100 for each nights performance. On the sixth night X wilfully absents herself from the theatre. Y is at liberty to put an end to the contract.
- (b) If in the above illustration, with the assent of Y, X sings on the seventh night, Y is presumed to have signified his acquiescence in the continuance of the contract and cannot put an end to it; but is entitled to compensation for the damages sustained by him through X's failure to sing on the sixth night.

### By whom contract must be performed

Under Section 40 of the Act, if it appears from the nature of the case that it was the intention of the parties to a contract that it should be performed by the promisor himself such promise must be performed by the promisor himself. In other cases, the promisor or his representative may employ a competent person to perform it.

### Illustration

- (a) X promises to pay Rs. 1,000 to Y. X may either personally pay the money to Y or cause it to be paid to Y by another. If X dies before making payment, his representatives must perform the promise or employ some proper person to do so.
- (b) X promises to paint a picture for Y. X must personally perform the promise.

### Devolution of Joint Liabilities

Under Section 42 of the Indian Contract Act, where two or more persons have made a joint promise then, *unless a contrary intention appears* from the contract all such persons should perform the promise. If any one of them dies, his representatives jointly with the survivor or survivors should perform. After the death of the last survivor, the representatives of all jointly must fulfil the promise.

Under Section 43 of the Indian Contract Act when two or more persons made a joint promise, the promisee may, in the *absence of an express agreement* to the contrary compel any one or more of such joint promisors to perform the whole of the promise. Each of two or more joint promisors may compel every other joint promisor to contribute equally with himself to the performance of the promise *unless a contrary intention appears from the contract*. If any one of two or more promisors make default in such contribution, the remaining joint promisors should bear the loss arising from such default in equal share.

### Illustrations

- (a) X, Y and Z jointly promise to pay Rs. 6,000 to A. A may compel either X or Y or Z to pay the amount.
- (b) In the above example imagine, Z is compelled to pay the whole amount; X is insolvent but his assets are sufficient to pay one-half of his debts. Z is entitled to receive Rs. 1,000 from X's estate and Rs. '2,500 from Y.
- (c) X, Y and Z make a joint promise to pay '5,000 to A, Z is unable to pay any amount and X is compelled to pay the whole. X is entitled to receive Rs. 2,500 from Y.

Under Section 44 of the Act, where two or more persons have made a joint promise, a release of one of such joint promisors by the promisee does not discharge the other joint promisor(s); neither does it free the joint promisor so released from responsibility to the other joint promisor or joint promisors.

### Devolution of Joint Rights

A promise may be made to two or more persons. The promisees are called joint promisees. For example, X may give a promise to repay Rs. 1,000 given by Y and Z jointly. In such case, *in the absence of a contrary intention*, the right to

claim, performance rests with Y and Z. If Y dies, Y's representative jointly with Z may demand performance. If Z also dies, the representatives of Y and Z may demand jointly performance from X.

### Assignment

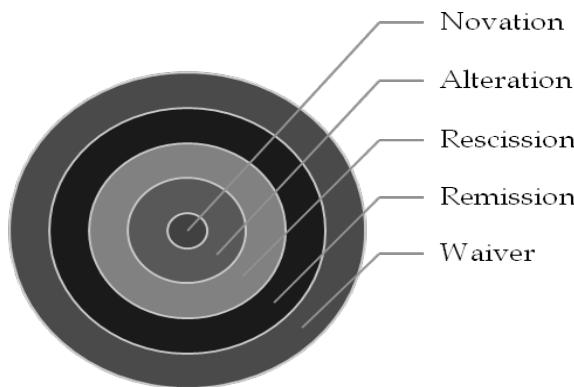
The promisee may assign rights and benefits of contract and the assignee will be entitled to demand performance by the promisor. But the assignment to be complete and effectual, must be made by an instrument in writing.

An obligation or liability under a contract cannot be assigned. For example, if A owes B Rs. 500 and A transfers the liability to C i.e. asks C to pay the sum to B, this would not bind B, and B may not consent to this arrangement, as he may know nothing of C's solvency. But if B consents to accept performance by C, there is a substitution of new contract and the old contract is discharged and all rights and liabilities under it are extinguished. This is technically called *novation*.

### (b) Discharge by Mutual Agreement or Consent (Sections 62 and 63)

A contract may be discharged by the agreement of all parties to the contract, or by waiver or release by the party entitled to performance.

**Methods stipulated under Sections 62 and 63 of the Indian Contract Act for discharging a contract by mutual consent are:**



*Novation* – when a new contract is substituted for existing contract either between the same parties or between different parties, the consideration mutually being the discharge of the old contract.

*Alteration* – change in one or more of the material terms of a contract.

*Rescission* – by agreement between the parties at any time before it is discharged by performance or in some other way.

*Remission* – acceptance of a lesser sum than what was contracted for or a lesser fulfilment of the promise made.

*Waiver* – deliberate abandonment or giving up of a right which a party is entitled to under a contract, where upon the other party to the contract is released from his obligation.

### (c) Discharge by Lapses of Time

The Limitation Act, in certain circumstance, affords a good defence to suits for breach of contract, and infact terminates the contract by depriving the party of his remedy to law. For example, where a debtor has failed to repay the loan on the stipulated date, the creditor must file the suit against him within three years of the default. If the limitation period of three years expires and he takes no action he will be barred from his remedy and the other party is discharged of his liability to perform.

### (d) Discharge by Operation of the Law

Discharge under this head may take place as follows:

- (a) By merger: When the parties embody the inferior contract in a superior contract.
- (b) By the unauthorised alteration of items of a written document: Where a party to a written contract makes any material alteration without knowledge and consent of the other, the contract can be avoided by the other party.
- (c) By insolvency: The Insolvency Act provides for discharge of contracts under particular circumstances. For example, where the Court passes an order discharging the insolvent, this order exonerates or discharges him from liabilities on all debts incurred previous to his adjudication.

### (e) Discharge by Impossibility or Frustration (Section 56)

A contract which is entered into to perform something that is clearly impossible is void. For instance, A agrees with B to discover treasure by magic. The agreement is void by virtue of Section 56 para 1 which lays down the principle that an agreement to do an act impossible in itself is void.

Sometimes subsequent impossibility (i.e. where the impossibility supervenes after the contract has been made) renders the performance of a contract unlawful and stands discharged; as for example, where a singer contracts to sing and becomes too ill to do so, the contract becomes void. In this connection, para 2 of Section 56 provides that a contract to do an act, which after the contract is made, becomes impossible or by reason of some event which the promisor could not prevent, unlawful, becomes void when the act becomes impossible or unlawful.

If the impossibility is not obvious and the promisor alone knows of the impossibility or illegally then existing or the promisor might have known as such after using reasonable diligence, such promisor is bound to compensate the promisee for any loss he may suffer through the non-performance of the promise inspite of the agreement being void *ab-initio* (Section 56, para 3).

In *Satyabarta Ghose v. Mugnuram* A.I.R. 1954 S.C. 44 the Supreme Court interpreted the term 'impossible' appearing in second paragraph of Section 56. The Court observed that the word 'impossible' has not been used here in the sense of physical or literal impossibility. The performance of an act may not be literally impossible but it may be impracticable and useless from the point of view of the object and purpose which the parties had in view; and if an untoward event or change of circumstances totally upsets the very foundation upon which the parties rested their bargain; it can very well be said that the promisor found it impossible to do the act which he promised to do. In this case, A undertook to sell a plot of land to B but before the plot could be developed, war broke out and the land was temporarily requisitioned by the Government. A offered to return earnest money to B in cancellation of contract. B did not accept and sued A for specific performance. A pleaded discharge by frustration. The Court held that Section 56 is not applicable on the ground that the requisition was of temporary nature and there was no time limit within which A was obliged to perform the contract. The impossibility was not of such a nature which would strike at the root of the contract.

### Discharge by Supervening Impossibility

A contract will be discharged by subsequent or supervening impossibility in any of the following ways:

- (a) Where the subject-matter of the contract is destroyed without the fault of the parties, the contract is discharged.
- (b) When a contract is entered into on the basis of the continued existence of a certain state of affairs, the contract is discharged if the state of things changes or ceases to exist.
- (c) Where the personal qualifications of a party is the basis of the contract, the contract is discharged by the death or physical disablement of that party.

### Discharge by Supervening Illegality

A contract which is contrary to law at the time of its formation is void. But if, after the making of the contract, owing to alteration of the law or the act of some person armed with statutory authority the performance of the contract becomes impossible, the contract is discharged. This is so because the performance of the promise is prevented or

prohibited by a subsequent change in the law. A enters into contract with B for cutting trees. By a statutory provision cutting of trees is prohibited except under a licence and the same is refused to A. The contract is discharged.

### Cases in which there is no supervening impossibility

In the following cases contracts are not discharged on the ground of supervening impossibility–

- (a) Difficulty of performance: The mere fact that performance is more difficult or expensive than the parties anticipated does not discharge the duty to perform.
- (b) Commercial impossibilities do not discharge the contract. A contract is not discharged merely because expectation of higher profits is not realised.
- (c) Strikes, lockouts and civil disturbance like riots do not terminate contracts unless there is a clause in the contract providing for non-performance in such cases.

Supervening impossibility or illegality is known as frustration under English Law.

### (f) Discharge by Breach

Where the promisor neither performs his contract nor does he tender performance, or where the performance is defective, there is a breach of contract. The breach of contract may be (i) actual; or (ii) anticipatory. The actual breach may take place either at the time the performance is due, or when actually performing the contract. Anticipatory breach means a breach before the time for the performance has arrived. This may also take place in two ways – by the promisor doing an act which makes the performance of his promise impossible or by the promisor in some other way showing his intention not to perform it.

#### Anticipatory Breach of Contract

Breach of contract may occur, before the time for performance is due. This may happen where one of the parties definitely renounces the contract and shows his intention not to perform it or does some act which makes performance impossible. The other party, on such a breach being committed, has a right of action for damages.

He may either sue for breach of contract immediately after repudiation or wait till the actual date when performance is due and then sue for breach. If the promisee adopts the latter course, i.e., waits till the date when performance is due, he keeps the contract alive for the benefit of the promisor as well as for his own. He remains liable under it and enables the promisor not only to complete the contract in spite of previous repudiation, but also to avail himself of any excuse for non-performance which may have come into existence before the time fixed for performance.

In *Hochester v. De La Tour* (1853) E.R. 922, A hired B in April to act as a courier commencing employment from 1st June, but wrote to B in May repudiating the agreement, B sued A for breach of contract immediately after repudiation. A contended that there could not be breach of contract before June 1. *Held*, B was immediately entitled to sue and need not wait till 1st June, for his right of action to accrue.

In *Avery v. Bowden* (1856) 116 E.R. 1122, A hired B's ship to carry a cargo from Russia. Later on B repudiated the contract. A delayed taking action hoping B would change his mind before the performance date. War broke out between Russia and Britain before the performance date frustrating the contract. *Held*, A lost his right to sue B for damages by his delay.

In *Frost v. Knight* (1872) L.R. 7 Ex. 111, the law on the subject of anticipatory breach was summed up as follows:

"The promisee if he pleases may treat the notice of intention as inoperative and await the time when the contract is to be executed and then hold the other party responsible for all the consequences of non-performance: but in that case he keeps the contract alive for the benefit of the other party as well as his own; he remains subject to all his own obligations and liabilities under it, and enables the other party not only to complete the contract, if so advised, notwithstanding his previous repudiation of it, but also to take advantage of any supervening circumstances which would justify him in declining to complete it."

## REMEDIES FOR BREACH

Where a contract is broken, the injured party has several courses of action open to him. The appropriate remedy in any case will depend upon the subject-matter of the contract and the nature of the breach.

### (i) Remedies for Breach of Contract

In case of breach of contract, the injured party may:

- (a) Rescind the contract and refuse further performance of the contract;
- (b) Sue for damages;
- (c) Sue for specific performance;
- (d) Sue for an injunction to restrain the breach of a negative term; and
- (e) Sue on quantum meruit

When a party to a contract has broken the contract, the other party may treat the contract as rescinded and he is absolved from all his obligations under the contract. Under Section 65, when a party treats the contract as rescinded, he makes himself liable to restore any benefits he has received under the contract to the party from whom such benefits were received. Under Section 75 of the Indian Contract Act, if a person rightfully rescinds a contract, he is entitled to a compensation for any damage which he has sustained through the non-fulfilment of the contract by the other party. Section 64 deals with consequences of rescission of voidable contracts, i.e., where there is flaw in the consent of one party to the contract. Under this Section when a person at whose option a contract is voidable rescinds, the other party thereto need not perform any promise therein contained in which he is the promisor. The party rescinding a voidable contract shall, if he has received any benefit thereunder, from another party to such contract, restore such benefit so far as may be, to the person from whom it was received.

### (ii) Damages for Breach of Contract

Under Section 73 of the Indian Contract Act, when a contract has been broken, a party who suffers by such breach is entitled to receive, from the party who has broken the contract, compensation for any loss or damage, caused to him thereby, *which naturally arose in the usual course of things from such breach or which the parties knew, when they made the contract to be likely to result from the breach of it*. Such compensation is not to be given for any remote and indirect loss or damage sustained by reason of the breach.

The foundation of the claim for damages rests in the celebrated case of *Hadley v. Baxendale*, (1854) 9 Ex. 341. The facts of this case were as follows:

There was a breakdown of a shaft in A's mill. He delivered the shaft to B, a common carrier to be taken to a manufacturer to copy and make a new one. A did not make known to B that delay would result in loss of profits. By some neglect on the part of B, the *delivery of the shaft was delayed in transit beyond a reasonable time*. As a result, the mill was idle for a longer period than it would otherwise have been, had there been no such delay. It was held, B was not liable for the loss of profits during the period of delay as the circumstances communicated to A did not show that the delay in the delivery of the shaft would entail loss of profits to the mill. In the course of the judgement it was observed:

"Where two parties have made a contract which one of them has broken, the damages which the other party ought to receive in respect of such breach of contract should be such as may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things from such breach of contract itself, or such as may reasonably be supposed to have been in the contemplation of both parties at the time they made the contract as the probable result of the breach of it. Now, if the special circumstances under which the contract was actually made were communicated by the plaintiffs to the defendants and thus known to both the parties, the damages resulting from the breach of such a contract which they would reasonably contemplate, would be the amount of injury which would ordinarily follow from a breach of contract under these special circumstances so known and communicated. But, on other hand, if these special circumstances were wholly unknown to the party breaking the contract, he at the most could only be supposed to have had in his contemplation, the amount of injury which would arise generally

and in the great multitude of cases not affected by any special circumstances from such breach of contract. For, had the special circumstances been known, the parties might have specially provided for the breach of contract by special terms as to damages in that case and of this advantage it would be very unjust to deprive them."

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*Liquidated* and *Unliquidated* damages: Where the contracting parties agree in advance the amount payable in the event of breach, the sum payable is called *liquidated damages*.

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Where the amount of compensation claimed for a breach of contract is left to be assessed by the Court, damages claimed are called *unliquidated damages*.

## Unliquidated Damages

Those are of the following kinds:

- (a) general or ordinary damages,
- (b) special damages
- (c) exemplary or punitive damages, and
- (d) nominal damages.

## Ordinary Damages

These are restricted to pecuniary compensation to put the injured party in the position he would have been had the contract been performed. It is the estimated amount of loss actually incurred. Thus, it applies only to the proximate consequences of the breach of the contract and the remote consequences are not generally regarded. For example, in a contract for the sale of goods, the damages payable would be the difference between the contract price and the price at which the goods are available on the date of the breach.

## Special Damages

Special damages are those resulting from a breach of contract under some peculiar circumstances. If at the time of entering into the contract, the party has notice of special circumstances which makes special loss the likely result of the breach in the ordinary course of things, then upon his-breaking the contract and the special loss following this breach, he will be required to make good the special loss. For example, A delivered goods to the Railway Administration to be carried to a place where an exhibition was being held and told the goods clerk that if the goods did not reach the destination on the stipulated date he would suffer a special loss. The goods reached late. He was entitled to claim special damages.

## Exemplary Damages

These damages are awarded to punish the defendant and are not, as a rule, granted in case of breach of contract. In two cases, however, the court may award such damages, viz.,

- (i) breach of promise to marry; and
- (ii) wrongful dishonour of a customer's cheque by the banker.

In a breach of promise to marry, the amount of the damages will depend upon the extent of injury to the party's feelings. In the bankers case, the smaller the amount of the cheque dishonoured, larger will be damages as the credit of the customer would be injured in a far greater measure, if a cheque for a small amount is wrongfully dishonoured.

## Nominal Damages

Nominal damages consist of a small token award, e.g., a rupee or even 25 paise, where there has been an infringement of contractual rights, but no actual loss has been suffered. These damages are awarded to establish the right to decree for breach of contract.

## Liquidated Damages and Penalty

Where the contracting parties fix at the time of contract the amount of damages that would be payable in case of breach, in English law, the question may arise whether the term amounts to "liquidated damages" or a "penalty"? The Courts in England usually give effect to liquidated damages, but they always relieve against penalty.

The test of the two is that where the amount fixed is a genuine pre-estimate of the loss in case of breach, it is liquidated damages and will be allowed. If the amount fixed is without any regard to probable loss, but is intended to frighten the party and to prevent him from committing breach, it is a penalty and will not be allowed.

In Indian law, there is no such difference between liquidated damages and penalty. Section 74 provides for "reasonable compensation" upto the stipulated amount whether it is by way of liquidated damages or penalty. For example, A borrows Rs. 500 from B and promises to pay Rs. 1,000 if he fails to repay Rs. 500 on the stipulated date. On A's failure to repay on the given date, B is entitled to recover from A such compensation, not exceeding Rs. 1,000 as the Court may consider reasonable. (*Union of India v. Raman Iron Foundry*, AIR 1974 SC 1265).

### (iii) Specific Performance

It means the actual carrying out by the parties of their contract, and in proper cases the Court will insist upon the parties carrying out this agreement. Where a party fails to perform the contract, the Court may, at its discretion, order the defendant to carry out his undertaking according to the terms of the contract. A decree for specific performance may be granted in addition to or instead of damages.

Specific performance is usually granted in contracts connected with land, e.g., purchase of a particular plot or house, or to take debentures in a company. In case of sale of goods, it will only be granted if the goods are unique and cannot be purchased in the market, e.g., a particular race horse, or one of special value to the party suing by reason of personal or family association, e.g., an heirloom.

Specific performance will not be ordered:

- (a) where monetary compensation is an adequate remedy;
- (b) where the Court cannot supervise the execution of the contract, e.g., a building contract;
- (c) where the contract is for personal service; and
- (d) where one of the parties is a minor.

### (iv) Injunction

An injunction, is an order of a Court restraining a person from doing a particular act. It is a mode of securing the specific performance of a negative term of the contract, (i.e., where he is doing something which he promises not to do), the Court may in its discretion issue an order to the defendant restraining him from doing what he promised not to do. Injunction may be prohibitory or mandatory. In prohibitory, the Court restrains the commission of a wrongful act whereas in mandatory, it restrains continuance of a wrongful commission.

In *Lumley v. Wagner* (1852) 90 R.R. 125. W agreed to sing at L's theatre and nowhere else. W, in breach of contract with L entered into a contract to sing for Z. Held, although W could not be compelled to sing at L's theatre, yet she could be restrained by injunction from singing for Z.

## CONTRACT OF INDEMNITY AND GUARANTEE (SECTIONS 124 TO 147)

### Meaning of Indemnity

A contract of indemnity is a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person (Section 124). For example, A contracts to indemnify B against the consequence of any proceedings which C may take against B in respect of a certain sum of 300 rupees. This is a contract of indemnity. The contract of indemnity may be express or implied. The later may

be inferred from the circumstances of a particular case, e.g., an act done by A at the request of B. If A incurs any expenses, he can recover the same from B.

The person who promises to indemnify or make good the loss is called the indemnifier and the person whose loss is made good is called the indemnified or the indemnity holder. A contract of insurance is an example of a contract of indemnity according to English Law. In consideration of premium, the insurer promises to make good the loss suffered by the assured on account of the destruction by fire of his property insured against fire.

Under the Indian Contract Act, the contract of indemnity is restricted to such cases only where the loss promised to be reimbursed, is caused by the conduct of the promisor or of any other person. The loss caused by events or accidents which do not depend on the conduct of any person, it seems, cannot be sought to be reimbursed under a contract of indemnity.

### **Rights of Indemnity Holder when Sued**

Under Section 125, the promisee in a contract of indemnity, acting within the scope of his authority, is entitled to recover from the promisor—

1. all damages which he may be compelled to pay in any suit in respect of any matter to which the promise to indemnify applies;
2. all costs which he may be compelled to pay in any such suit if, in bringing or defending it, he did not contravene the orders of the promisor, and acted as if it would have been prudent for him to act in the absence of any contract of indemnity, or if the promisor authorised him to bring or defend the suit; and
3. all sums which he may have paid under the terms of any compromise of any such suit, if the compromise was not contrary to the orders of the promisor, and was one which it would have been prudent for the promisee to make in the absence of any contract of indemnity, or if the promisor authorised him to compromise the suit.

### **Meaning of Contract of Guarantee**

A contract of guarantee is a contract to perform the promise, or discharge the liability of a third person in case of his default. The person who gives the guarantee is called the Surety, the person for whom the guarantee is given is called the Principal Debtor, and the person to whom the guarantee is given is called the Creditor (Section 126). A guarantee may be either oral or written, although in the English law, it must be in writing.

#### **Illustration**

A advances a loan of Rs. 5,000 to B and C promises to A that if B does not repay the loan, C will do so. This is a contract of guarantee. Here B is the principal debtor, A is the creditor and C is the surety or guarantor.

Like a contract of indemnity, a guarantee must also satisfy all the essential elements of a valid contract. There is, however, a special feature with regard to consideration in a contract of guarantee. The consideration received by the principal debtor is sufficient for surety. Section 127 provides that anything done or any promise made for the benefit of the principal debtor may be a sufficient consideration to the surety for giving the guarantee.

#### **Illustration**

- (i) B requests A to sell and deliver to him goods on credit. A agrees to do so, provided C will guarantee the payment of the price of the goods. C promises to guarantee the payment in consideration of A's promise to deliver the goods. This is sufficient consideration for C's promise.
- (ii) A sells and delivers goods to B. C afterwards requests A to forbear to sue B for the debt for a year, and promises that if he does so, C will pay for them in default of payment by B. A agrees to forbear as requested. This is sufficient consideration for C's promise.

## Distinction between Indemnity and Guarantee

A contract of indemnity differs from a contract of guarantee in the following ways:

- (a) In a contract of indemnity there are only two parties: the indemnifier and the indemnified. In a contract of guarantee, there are three parties; the surety, the principal debtor and the creditor.
- (b) In a contract of indemnity, the liability of the indemnifier is primary. In a contract of guarantee, the liability of the surety is secondary. The surety is liable only if the principal debtor makes a default, the primary liability being that of the principal debtor.
- (c) The indemnifier need not necessarily act at the request of the debtor; the surety gives guarantee only at the request of the principal debtor.
- (d) In the case of a guarantee, there is an existing debt or duty, the performance of which is guaranteed by the surety, whereas in the case of indemnity, the possibility of any loss happening is the only contingency against which the indemnifier undertakes to indemnify.
- (e) The surety, on payment of the debt when the principal debtor has failed to pay is entitled to proceed against the principal debtor in his own right, but the indemnifier cannot sue third-parties in his own name, unless there be assignment. He must sue in the name of the indemnified.

## Extent of Surety's Liability

The liability of the surety is co-extensive with that of the principal debtor unless the contract otherwise provides (Section 128). A creditor is not bound to proceed against the principal debtor. He can sue the surety without suing the principal debtor. As soon as the debtor has made default in payment of the debt, the surety is immediately liable. But until default, the creditor cannot call upon the surety to pay. In this sense, the nature of the surety's liability is secondary.

### Illustration

A guarantees to B the payment of a bill of exchange by C, the acceptor. The bill is dishonoured by C. A is liable not only for the amount of the bill but also for any interest and charges which may have become due on it.

Section 128 only explains the quantum of a surety's obligation when terms of the contract do not limit it. Conversely it doesn't follow that the surety can never be liable when the principal debtor cannot be held liable. Thus, a surety is not discharged from liability by the mere fact that the contract between the principal debtor and creditor was voidable at the option of the former, and was avoided by the former. Where the agreement between the principal debtor and creditor is void as for example in the case of minority of principal debtor, the surety is liable as a principal debtor; for in such cases the contract of the so-called surety is not collateral, but a principal contract (*Kashiba v. Shripat* (1894) 19 Bom. 697).

## Kinds of Guarantees

A contract of guarantee may be for an existing debt, or for a future debt. It may be a specific guarantee, or it may be a continuing guarantee. A specific guarantee is given for a single debt and comes to an end when the debt guaranteed has been paid.

A continuing guarantee is one which extends to a series of transactions (Section 129). The liability of surety in case of a continuing guarantee extends to all the transactions contemplated until the revocation of the guarantee. As for instance, S, in consideration that C will employ P in collecting the rents of C's Zamindari, promises C to be responsible to the amount of Rs. 5,000 for the due collection and payment by P of these rents. This is a continuing guarantee.

## Revocation of Continuing Guarantee

A continuing guarantee is revoked in the following circumstances:

- (a) By notice of revocation by the surety (Section 130): The notice operates to revoke the surety's liability as regards future transactions. He continues to be liable for transactions entered into prior to the notice (*Offord v. Davies (1862) 6 L.T.S. 79*).
- (b) By the death of the surety: The death of the surety operates, in the absence of contract (*Lloyds v. Harper (1881) 16 Ch. D. 290*) as a revocation of a continuing guarantee, so far as regards future transactions (Section 131). But for all the transactions made before his death, the surety's estate will be liable.

### Rights of Surety

A surety has certain rights against the creditor, (Section 141) the principal debtor (Sections 140 and 145) and the co-securities (Sections 146 and 147). Those are—

- (a) Surety's rights against the creditor: Under Section 141 a surety is entitled to the benefit of every security which the creditor has against the principal debtor at the time when the contract of suretyship is entered into whether the surety knows of the existence of such security or not; and, if the creditor losses or, without the consent of the surety parts with such security, the surety is discharged to the extent of the value of the security.
- (b) Rights against the principal debtor: After discharging the debt, the surety steps into the shoes of the creditor or is subrogated to all the rights of the creditor against the principal debtor. He can then sue the principal debtor for the amount paid by him to the creditor on the debtors default; he becomes a creditor of the principal debtor for what he has paid.

In some circumstances, the surety may get certain rights even before payment. The surety has remedies against the principal debtor before payment and after payment. In *Mamta Ghose v. United Industrial Bank (AIR 1987 Cal. 180)* where the principal debtor, after finding that the debt became due, started disposing of his properties to prevent seizure by surety, the Court granted an injunction to the surety restraining the principal debtor from doing so. The surety can compel the debtor, after debt has become due to exonerate him from his liability by paying the debt.

- (c) Surety's rights gains co-sureties: When a surety has paid more than his share of debt to the creditor, he has a right of contribution from the co-securities who are equally bound to pay with him. A, B and C are sureties to D for the sum of Rs. 3,000 lent to E who makes default in payment. A, B and C are liable, as between themselves to pay Rs. 1,000 each. If any one of them has to pay more than Rs. 1,000 he can claim contribution from the other two to reduce his payment to only Rs. 1,000. If one of them becomes insolvent, the other two shall have to contribute the unpaid amount equally.

### Discharge of Surety

A surety may be discharged from liability under the following circumstances:

- (a) By notice of revocation in case of a continuing guarantee as regards future transaction (Section 130.)
- (b) By the death of the surety as regards future transactions, in a continuing guarantee in the absence of a contract to the contrary (Section 131).
- (c) Any variation in the terms of the contract between the creditor and the principal debtor, without the consent of the surety, discharges the surety as regards all transactions taking place after the variation (Section 133).
- (d) A surety will be discharged if the creditor releases the principal debtor, or acts or makes an omission which results in the discharge of the principal debtor (Section 134). But where the creditor fails to sue the principal debtor within the limitation period, the surety is not discharged.
- (e) Where the creditor, without the consent of the surety, makes an arrangement with the principal debtor for composition, or promises to give time or not to sue him, the surety will be discharged (Section 135).
- (f) If the creditor does any act which is against the rights of the surety, or omits to do an act which his duty to the surety requires him to do, and the eventual remedy of the surety himself against the principal debtor is thereby impaired, the surety is discharged (Section 139).

- (g) If the creditor loses or parts with any security which at the time of the contract the debtor had given in favour of the creditor, the surety is discharged to the extent of the value of the security, unless the surety consented to the release of such security by creditor in favour of the debtor. It is immaterial whether the surety was or is aware of such security or not (Section 141).

## CONTRACT OF BAILMENT AND PLEDGE

### (a) Bailment

A bailment is a transaction whereby one person delivers goods to another person for some purpose, upon a contract that they are, when the purpose is accomplished to be returned or otherwise disposed of according to the directions of the person delivering them (Section 148). The person who delivers the goods is called the *bailor* and the person to whom they are delivered is called the *bailee*.

Bailment is a *voluntary delivery of goods for a temporary purpose* on the understanding that *they are to be returned in specie* in the same or altered form. The ownership of the goods remains with the bailor, the bailee getting only the possession. Delivery of goods may be actual or constructive, e.g., where the key of a godown is handed over to another person, it amounts to delivery of goods in the godown.

### Gratuitous Bailment

A gratuitous bailment is one in which neither the bailor nor the bailee is entitled to any remuneration. Such a bailment may be for the exclusive benefit of the bailor, e.g., when A leaves his dog with a neighbour to be looked after in A's absence on a holiday. It may again be for exclusive benefit of the bailee, e.g., where you lend your book to a friend of yours for a week. In neither case any charge is made.

A gratuitous bailment terminates by the death of either the bailor or the bailee (Section 162).

Under Section 159 the lender of a thing for use may at any time require its return if the loan was gratuitous, even though he lent it for a specified time or purpose. But if on the faith of such loan made for a specified time or purpose, the borrower has acted in such a manner that the return of the thing lent before the time agreed upon would cause him loss exceeding the benefit actually derived by him from the loan, the lender must, if he compels the return, indemnify the borrower the amount in which the loss so occasioned exceeds the benefit so derived.

### Bailment for Reward

This is for the mutual benefit of both the bailor and the bailee. For example, A lets out a motor-car for hire to B. A is the bailor and receives the hire charges and B is the bailee and gets the use of the car. Where, A hands over his goods to B, a carrier for carriage at a price, A is the bailor who enjoys the benefit of carriage and B is the bailee who receives a remuneration for carrying the goods.

### Duties of Bailee

The bailee owes the following duties in respect of the goods bailed to him:

- (a) The bailee must take as much care of the goods bailed to him as a man of ordinary prudence would take under similar circumstances of his own goods of the same bulk, quality and value as the goods bailed (Section 151). If he takes this much care he will not be liable for any loss, destruction or deterioration of the goods bailed (Section 152). The degree of care required from the bailee is the same whether the bailment is for reward or gratuitous.

Of course, the bailee may agree to take special care of the goods, e.g., he may agree to keep the property safe from all perils and answers for accidents or thefts. But even such a bailee will not be liable for loss happening by an act of God or by public enemies.

- (b) The bailee is under a duty not to use the goods in an unauthorised manner or for unauthorised purpose (Section 153). If he does so, the bailor can terminate the bailment and claim damages for any loss or damage caused by the unauthorised use (Section 154).

- (c) He must keep the goods bailed to him separate from his own goods (Sections 155-157).

If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods, the bailor and the bailee shall have an interest, in proportion to their respective shares, in the mixture thus produced. If the bailee without the consent of the bailor, mixes the goods of the bailor with his own goods, and the goods can be separated or divided, the property in the goods remains in the parties respectively; but the bailee is bound to bear the expenses of separation, and any damages arising from the mixture.

If the bailee without the consent of the bailor mixes, the goods of the bailor with his own goods, in such a manner that it is impossible to separate the goods bailed from the other goods and deliver them back, the bailor is entitled to be compensated by the bailee for the loss of goods.

- (d) He must not set up an adverse title to the goods.

- (e) It is the duty of the bailee to return the goods without demand on the expiry of the time fixed or when the purpose is accomplished (Section 160). If he fails to return them, he shall be liable for any loss, destruction or deterioration of the goods even without negligence on his part (Section 161).

- (f) In the absence of any contract to the contrary, the bailee must return to the bailor any increase, or profits which may have accrued from the goods bailed; for example, when A leaves a cow in the custody of B to be taken care of and the cow gets a calf, B is bound to deliver the cow as well as the calf to A (Section 163).

### Bailees Particular Lien (Section 170)

Where the goods are bailed for a particular purpose and the bailee in due performance of bailment, expands his skill and labour, he has in the absence of an agreement to the contrary a lien on the goods, i.e., the bailee can retain the goods until his charges in respect of labour and skill used on the goods are paid by the bailor. A gives a piece of cloth to B, a tailor, for making it into a suit, B promises to have the suit ready for delivery within a fortnight, B has the suit ready for delivery. He has a right to retain the suit until he is paid his dues. The section expresses the Common Law principle that if a man has an article delivered to him on the improvement of which he has to bestow trouble and expenses, he has a right to detain it until his demand is paid.

The right of lien arises only where labour and skill have been used so as to confer an additional value on the article.

### Particular and General Lien

Lien is of two kinds: Particular lien and General lien. A particular lien is one which is available only against that property of which the skill and labour have been exercised. A bailee's lien is a particular lien.

A *general lien* is a right to detain any property belonging to the other and in the possession of the person trying to exercise the lien in respect of any payment lawfully due to him.

Thus, a general lien is the right to retain the property of another for a general balance of accounts but a particular lien is a right to retain only for a charge on account of labour employed or expenses bestowed upon the identical property detained.

The right of general lien is expressly given by Section 171 of the Indian Contract Act to bankers, factors, warfingers, attorneys of High Court and policy-brokers, provided there is no agreement to the contrary.

## Duties of bailor

The bailor has the following duties:

- (a) The bailor must disclose all the known faults in the goods; and if he fails to do that, he will be liable for any damage resulting directly from the faults (Section 150). For example, A delivers to B, a carrier, some explosive in a case, but does not warn B. The case is handled without extraordinary care necessary for such articles and explodes. A is liable for all the resulting damage to men and other goods.  
In the case of bailment for hire, a still greater responsibility is placed on the bailor. He will be liable even if he did not know of the defects (Section 150). A hires a carriage of B. The carriage is unsafe though B does not know this. A is injured. B is responsible to A for the injury.
- (B) It is the duty of the bailor to pay any extraordinary expenses incurred by the bailee. For example, if a horse is lent for a journey, the expense of feeding the horse would, of course, subject to any special agreement be borne by the bailee. If however the horse becomes ill and expenses have been incurred on its treatment, the bailor shall have to pay these expenses (Section 158).
- (C) The bailor is bound to indemnify the bailee for any cost or costs which the bailee may incur because of the defective title of the bailor of the goods bailed (Section 164).

## Termination of bailment

Where the bailee wrongfully uses or dispose of the goods bailed, the bailor may determine the bailment (Section 153.)

As soon as the period of bailment expires or the object of the bailment has been achieved, the bailment comes to an end, and the bailee must return the goods to the bailor (Section 160). Bailment is terminated when the subject matter of bailment is destroyed or by reason of change in its nature, becomes incapable of use for the purpose of bailment.

A gratuitous bailment can be terminated by the bailor at any time, even before the agreed time, subject to the limitation that where termination before the agreed period causes loss in excess of benefit, the bailor must compensate the bailee (Section 159).

A gratuitous bailment terminates by the death of either the bailor or the bailee (Section 162).

## Finder of Lost Goods

The position of a finder of lost goods is exactly that of a bailee. The rights of a finder are that he can sue the owner for any reward that might have been offered, and may retain the goods until he receives the reward. But where the owner has offered no reward, the finder has only a particular lien and can detain the goods until he receives compensation for the troubles and expenses incurred in preserving the property for finding out the true owner. But he cannot file a suit for the recovery of the compensation [Section 168].

Thus, as against the true owner, the finder of goods in a public or quasi public place is only a bailee; he keeps the article in trust for the real owner. As against every-one else, the property in the goods vests in the finder on his taking possession of it.

The finder has a right to sell the property—

- (a) where the owner cannot with reasonable diligence be found, or
- (b) when found, he refuses to pay the lawful charges of the finder and—
  - (i) if the thing is in danger of perishing or losing greater part of its value, or
  - (ii) when the lawful charges of the finder for the preservation of goods and the finding out of the owner amounts to two-thirds of the value of the thing (Section 169).

## Carrier as Bailee

A common carrier undertakes to carry goods of all persons who are willing to pay his usual or reasonable rates. He further undertakes to carry them safely, and make good all losses, unless they are caused by act of God or public enemies. Carriers by land including railways and carriers by inland navigation, are common carriers. Carriers by Sea for hire are not common carriers and they can limit their liability. Railways in India are now common carriers.

*Inn-keepers:* The liability of a hotel keeper is governed by Sections 151 and 152 of the Contract Act and is that of an ordinary bailee with regard to the property of the guests.

C stayed in a room in a hotel. The hotel-keeper knew that the room was in an insecure condition. While C was dining in the dining room, some articles were stolen from his room. It was held that the hotel-keeper was liable as he should have taken reasonable steps to rectify the insecure condition of the rooms (*Jan & San v. Caneron* (1922) 44 All. 735).

## (b) Pledge

Pledge or pawn is a contract whereby an article is deposited with a lender of money or promisee as security for the repayment of a loan or performance of a *promise*. The bailor or depositor is called the Pawnor and the bailee or depositor the "Pawnee" (Section 172). Since pledge is a branch of bailment, the pawness is bound to take reasonable care of the goods pledged with him. Any kind of goods, valuables, documents or securities may be pledged. The Government securities, e.g., promissory notes must, however, be pledged by endorsement and delivery.

The following are the essential ingredients of a pledge:

- (i) The property pledged should be delivered to the pawnee.
- (ii) Delivery should be in pursuance of a contract.
- (iii) Delivery should be for the purpose of security.
- (iv) Delivery should be upon a condition to return.

## Rights of the Pawnee

No property in goods pawned passes to the pawnee, but the pawnee gets a "special property to retain possession even against the true owner until the payment of the debt, interest on the debt, and any other expense incurred in respect of the possession or for preservation of the goods pledged" (Section 173). The pawnee must return the goods to the pawnor on the tender of all that is due to him. The pawnee cannot confer a good title upon a *bona fide* purchaser for value.

Should the pawnor make a default in payment of the debt or performance of the promise at the stipulated time, the pawnee may-

- (i) file a suit for the recovery of the amount due to him while retaining the goods pledged as collateral security; or
- (ii) sue for the sale of the goods and the realisation of money due to him; or
- (iii) himself sell the goods pawned, after giving reasonable notice to the pawnor, sue for the deficiency, if any, after the sale.

If the sale is made in execution of a decree, the pawnee may buy the goods at the sale. But he cannot sell them to himself in a sale made by himself under (iii) above. If after sale of the goods, there is surplus, the pawnee must pay it to the pawnor (Section 176).

## Rights of Pawnor

On default by pawnor to repay on the stipulated date, the pawnee may sell the goods after giving reasonable notice to the pawnor. If the pawnee makes an unauthorised sale without giving notice to the pawnor, the pawnor has the following rights—

- (i) He can file a suit for redemption of goods by depositing the money treating the sale as if it had never taken place; or He can ask for damages on the ground of conversion.

## Pledge by Non-owners

- (a) Ordinarily, the owner of the goods would pledge them to secure a loan but the law permits under certain circumstances a pledge by a person who is not the owner but is in possession of the goods. Thus, a valid pledge may be created by the following non-owners.
- A mercantile agent: Where a mercantile agent is, with the consent of the owner, in possession of goods or the documents of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, is as valid as if he were expressly authorised by the owner of the goods to make the same. But the pledge is valid only if the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor has not the authority to pledge (Section 178).
- (b) Pledge by seller or buyer in possession after sale: A seller, left in possession of goods sold, is no more the owner, but pledge by him will be valid, provided the pawnee acted in good faith and had no notice of the sale of goods to the buyer (Section 30 of The Sale of Goods Act 1930).
- (c) Pledge where pawnor having limited interest: When the pawnor is not the owner of the goods but has a limited interest in the goods which he pawns, e.g., he is a mortgagee or he has a lien with respect of these goods, the pledge will be valid to the extent of such interest.
- (d) Pledge by co-owner in possession: One of the several co-owners of goods in possession thereof with the assent of the other co-owners may create a valid pledge of the goods.
- (e) Pledge by person in possession under a voidable contract: A person may obtain possession under a contract which is voidable at the option of the lawful owner on the ground of misrepresentation, fraud, etc. The person in possession may pledge the goods before the contract is avoided by the other party (Section 178A).

## LAW OF AGENCY

### Definition of Agent (Section 182)

An agent is a person who is employed to bring his principal into contractual relations with third-parties. As the definition indicates, an agent is a mere connecting link between the principal and a third-party. But during the period that an agent is acting for his principal, he is clothed with the capacity of his principal.

### Creation of Agency

A contract of agency may be express or implied, (Section 186) but consideration is not an essential element in this contract (Section 185). Agency may also arise by estoppel, necessity or ratification.

- (a) Express Agency: A contract of agency may be made orally or in writing. The usual form of written contract of agency is the Power of Attorney, which gives him the authority to act on behalf of his principal in accordance with the terms and conditions therein. In an agency created to transfer immovable property, the power of attorney must be registered. A power of attorney may be general, giving several powers to the agent, or special, giving authority to the agent for transacting a single act.
- (b) Implied Agency: Implied agency may arise by conduct, situation of parties or necessity of the case.
- (i) Agency by Estoppel (Section 237): Estoppel arises when you are precluded from denying the truth of anything which you have represented as a fact, although it is not a fact. Thus, where P allows third-parties to believe that A is acting as his authorised agent, he will be estopped from denying the agency if such third-parties relying on it make a contract with A even when A had no authority at all.
- (ii) Wife as agent: Where a husband and wife are living together, the wife is presumed to have her husband's authority to pledge his credit for the purchase of necessaries of life suitable to their standard of living. But the husband will not be liable if he shows that (i) he had expressly warned the tradesman not to supply goods on credit to his wife; or (ii) he had expressly forbidden the wife to pledge his credit; or (iii) his wife was already sufficiently supplied with the articles in question; or (iv) she was supplied with a sufficient allowance.

Similarly, where any person is held out by another as his agent, the third-party can hold that person liable for the acts of the ostensible agent, or the agent by holding out. Partners are each others agents for making contracts in the ordinary course of the partnership business.

(iii) **Agency of Necessity** (Sections 188 and 189): In certain circumstances, a person who has been entrusted with another's property, may have to incur unauthorised expenses to protect or preserve it. Such an agency is called an agency of necessity. For example, A sent a horse by railway and on its arrival at the destination there was no one to receive it. The railway company, being bound to take reasonable steps to keep the horse alive, was an agent of necessity of A.

A wife deserted by her husband and thus forced to live separate from him, can pledge her husband's credit to buy all necessities of life according to the position of the husband even against his wishes.

(iv) **Agency by ratification** (Sections 169-200): Where a person having no authority purports to act as agent, or a duly appointed agent exceeds his authority, the principal is not bound by the contract supposedly based on his behalf. But the principal may ratify the agent's transaction and so accept liability. In this way an agency by ratification arises. This is also known as *ex post facto* agency—agency arising after the event. The effect of ratification is to render the contract binding on the principal as if the agent had been authorised before hand. Also ratification relates back to the original making of the contract so that the agency is taken to have come into existence from the moment the agent first acted, and not from the date the principal ratified it.

Ratification is effective only if the following conditions are satisfied –

- The agent must expressly contract as agent for a principal who is in existence and competent to contract.
- The principal must be competent to contract not only at the time the agent acted, but also when he ratified the agent's act.
- The principal at the time of ratification has full knowledge of the material facts, and must ratify the whole contract, within a reasonable time.
- Ratification cannot be made so as to subject a third-party to damages, or terminate any right or interest of a third person.
- Only lawful acts can be ratified.

## Classes of Agents

Agents may be special or general or, they may be mercantile agents:

- Special Agent:** A special agent is one who is appointed to do a specified act, or to perform a specified function. He has no authority outside this special task. The third-party has no right to assume that the agent has unlimited authority. Any act of the agent beyond that authority will not bind the principal.
- General Agent:** A general agent is appointed to do anything within the authority given to him by the principal in all transactions, or in all transactions relating to a specified trade or matter. The third-party may assume that such an agent has power to do all that is usual for a general agent to do in the business involved. The third party is not affected by any private restrictions on the agent's authority.

## Sub-Agent

A person who is appointed by the agent and to whom the principal's work is delegated is known as sub-agent. Section 191 provides that "a sub-agent is a person employed by, and acting under the control of the original agent in the business of the agency." So, the sub-agent is the agent of the original agent.

As between themselves, the relation of sub-agent and original agent is that of agent and the principal. A sub-agent is bound by all the duties of the original agent. The sub-agent is not directly responsible to the principal except for fraud and wilful wrong. The sub-agent is responsible to the original agent. The original agent is responsible to the principal for the acts of the sub-agent. As regards third persons, the principal is represented by sub-agent and he is bound and responsible for all the acts of sub-agent as if he were an agent originally appointed by the principal.

## Mercantile Agent

Section 2(9) of the Sale of Goods Act, 1930, defines a mercantile agent as "a mercantile agent having in the customary course of business as such agent authority either to sell goods or consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods". This definition covers factors, brokers, auctioneers, commission agents etc.

### Factors

A factor is a mercantile agent employed to sell goods which have been placed in his possession or contract to buy goods for his principal. He is the apparent owner of the goods in his custody and can sell them in his own name and receive payment for the goods. He has an insurable interest in the goods and also a general lien in respect of any claim he may have arising out of the agency.

### Brokers

A broker is a mercantile agent whose ordinary course of business is to make contracts with other parties for the sale and purchase of goods and securities of which he is not entrusted with the possession for a commission called brokerage. He acts in the name of principal. He has no lien over the goods as he is not in possession of them.

### Del Credere Agent

A *del credere* agent is a mercantile agent, who is in consideration of an extra remuneration guarantees to his principal that the purchasers who buy on credit will pay for the goods they take. In the event of a third-party failing to pay, the *del credere* agent is bound to pay his principal the sum owned by third-party.

### Auctioneers

An auctioneer is an agent who sells goods by auction, i.e., to the highest bidder in public competition. He has no authority to warrant his principal's title to the goods. He is an agent for the seller but after the goods have been knocked down he is agent for the buyer also for the purpose of evidence that the sale has taken place.

### Partners

In a partnership firm, every partner is an agent of the firm and of his co-partners for the purpose of the business of the firm.

### Bankers

The relationship between a banker and his customer is primarily that of debtor and creditor. In addition, a banker is an agent of his customer when he buys or sells securities, collects cheques dividends, bills or promissory notes on behalf of his customer. He has a general lien on all securities and goods in his possession in respect of the general balance due to him by the customer.

### Duties of the Agent

An agent's duties towards his principal are as follows (which give corresponding rights to the principal who may sue for damages in the event of a breach of duty by the agent):

- (a) An agent must act within the scope of the authority conferred upon him and carry out strictly the instructions of the principal (Section 211).
- (b) in the absence of express instructions, he must follow the custom prevailing in the same kind of business at the place where the agent conducts the business (Section 211).
- (c) He must do the work with reasonable skill and diligence whereby the nature of his profession, the agent purports to have special skill, he must exercise the skill which is expected from the members of the profession (Section 212).
- (d) He must disclose promptly any material information coming to his knowledge which is likely to influence the principal in the making of the contract.

- (e) He must not disclose confidential information entrusted to him by his principal (Section 213).
- (f) He must not allow his interest to conflict with his duty, e.g., he must not compete with his principal (Section 215).
- (g) The agent must keep true accounts and must be prepared on reasonable notice to render an account.
- (h) He must not make any secret profit; he must disclose any extra profit that he may make.

Where an agent is discovered taking secret bribe, etc., the principal is entitled to (i) dismiss the agent without notice, (ii) recover the amount of secret profit, and (iii) refuse to pay the agent his remuneration. He may repudiate the contract, if the third-party is involved in secret profit and also recover damages.

- (i) An agent must not delegate his authority to sub-agent. A sub-agent is a person employed by and acting under the control of the original agent in the business of agency (Section 191). This rule is based on the principle: *Delegatus non-potest delegare* — a delegate cannot further delegate (Section 190).

But there are exceptions to this rule and the agent may delegate (i) where delegation is allowed by the principal, (ii) where the trade custom or usage sanctions delegation, (iii) where delegation is essential for proper performance, (iv) where an emergency renders it imperative, (v) where nature of the work is purely ministerial, and (vi) where the principal knows that the agent intends to delegate.

## Rights of Agents

Where the services rendered by the agent are not gratuitous or voluntary, the agent is entitled to receive the agreed remuneration, or if none was agreed, a reasonable remuneration. The agent becomes entitled to receive remuneration as soon as he has done what he had undertaken to do (Section 219).

Certain classes of agents, e.g., factors who have goods and property of their principal in their possession, have a lien on the goods or property in respect of their remuneration and expense and liabilities incurred. He has a right to stop the goods in transit where he is an unpaid seller.

As the agent represents the principal, the agent has a right to be indemnified by the principal against all charges, expenses and liabilities properly incurred by him in the course of the agency (Sections 222-223).

## Extent of Agent's Authority

The extent of the authority of an agent depends upon the terms expressed in his appointment or it may be implied by the circumstances of the case. The contractual authority is the real authority, but implied authority is to do whatevers incidental to carry out the real authority. This implied authority is also known as apparent or ostensible authority. Thus, an agent having an authority to do an act has authority to do everything lawful which is necessary for the purpose or usually done in the course of conducting business.

An agent has authority to do all such things which may be necessary to protect the principal from loss in an emergency and which he would do to protect his own property under similar circumstances. Where butter was becoming useless owing to delay in transit and was therefore sold by the station master for the best price available as it was not possible to obtain instructions from the principal, the sale was held binding upon the principal.

## Responsibilities of Principal to Third-parties

The effect of a contract made by an agent varies according to the circumstances under which the agent contracted. There are three circumstances in which an agent may contract, namely—

- (a) the agent acts for a named principal;
- (b) the agent acts for an undisclosed principal; and
- (c) the agent acts for a concealed principal.

*(a) Disclosed principal:* Where the agent contracts as agent for a named principal, he generally incurs neither rights nor liabilities under the contract, and drops out as soon as it is made. The contract is made between the principal and the third-party and it is between these two that rights and obligations are created. The legal effect is the same as if the principal had contracted directly with the third-party.

The effect is that the principal is bound by all acts of the agent done within the scope of actual, apparent or ostensible authority. This ostensible authority of the agent is important, for the acts of a general agent are binding on the principal if they are within the scope of his apparent authority, although they may be outside the scope of his actual authority. Therefore, a private or secret limitation or restriction of powers of an agent do not bind innocent third-party.

(b) *Undisclosed principal:* Where the agent disclose that he is merely an agent but conceals the identity of his principal, he is not personally liable, as he drops out in normal way. The principal, on being discovered, will be responsible for the contract made by the agent.

(c) *Concealed principal:* Where an agent appears to be contracting on his own behalf, without either contracting as an agent or disclosing the existence of an agency (i.e., he discloses neither the name of the principal nor his existence), he becomes personally liable. The third-party may sue either the principal (when discovered) or the agent or both. If the third-party chooses to sue the principal and not the agent, he must allow the principal the benefit of all payments made by him to the agent on account of the contract before the agency was disclosed. The third-party is also entitled to get the benefit of anything he may have paid to the agent.

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

### Principal Liable for Agent's Torts (Section 238)

If an agent commits a tort or other wrong (e.g., misrepresentation or fraud) during his agency, whilst acting within the scope of his actual or apparent authority, the principal is liable. But the agent is also personally liable, and he may be sued also. The principal is liable even if the tort is committed exclusively for the benefit of the agent and against the interests of the principal.

### Personal Liability of Agent to Third-party

An agent is personally liable in the following cases:

- (a) Where the agent has agreed to be personally liable to the third-party.
- (b) Where an agent acts for a principal residing abroad.
- (c) When the agent signs a negotiable instrument in his own name without making it clear that he is signing it only as agent.
- (d) When an agent acts for a principal who cannot be sued (e.g., he is minor), the agent is personally liable.
- (e) An agent is liable for breach of warranty of authority. Where a person contracts as agent without any authority there is a breach of warranty of authority. He is liable to the person who has relied on the warranty of authority and has suffered loss.
- (f) Where authority is one coupled with interest or where trade, usage or custom makes the agent personally liable, he will be liable to the third-party.
- (g) He is also liable for his torts committed in the course of agency.

### Meaning of Authority Coupled with Interest (Section 202)

An agency is coupled with an interest when the agent has an interest in the authority granted to him or when the agent has an interest in the subject matter with which he is authorised to deal. Where the agent was appointed to enable him to secure some benefit already owed to him by the principal, the agency was coupled with an interest. For example, where a factor had made advances to the principal and is authorised to sell at the best price and recoup the advances made by him or where the agent is authorised to collect money from third-parties and pay himself the debt due by the principal, the agencies are coupled with interest. But a mere arrangement that the agent's remuneration to paid out of the rents collected by him, it does not give him any interest in the property and

the agency is not the one coupled with an interest. An agency coupled with interest cannot be terminated in the absence of a contract to the contrary to the prejudice of such interest.

The principal laid down in Section 202 applies only if the following conditions are fulfilled:

- (a) The interest of the agent should exist at the time of creation of agency and should not have arisen after the creation of agency.
- (b) Authority given to the agent must be intended for the protection of the interest of the agent.
- (c) The interest of the agent in the subject matter must be substantial and not ordinary.
- (d) The interest of the agent should be over and above his remuneration. Mere prospect of remuneration is not sufficient interest.

## Termination of Agency

An agency comes to an end or terminates—

- (a) By the performance of the contract of agency; (Section 201)
- (b) By an agreement between the principal and the agent;
- (c) By expiration of the period fixed for the contract of agency;
- (d) By the death of the principal or the agency; (Section 201)
- (e) By the insanity of either the principal or the agent; (Section 201)
- (f) By the insolvency of the principal, and in some cases that of the agent; (Section 201)
- (g) Where the principal or agent is an incorporated company, by its dissolution;
- (h) By the destruction of the subject-matter; (Section 56)
- (i) By the renunciation of his authority by the agent; (Section 201)
- (j) By the revocation of authority by the principal. (Section 201)

## When Agency is Irrevocable

Revocation of an agency by the principal is not possible in the following cases:

- (a) Where the authority of agency is one coupled with an interest, even the death or insanity of the principal does not terminate the authority in this case (Section 202).
- (b) When agent has incurred personal liability, the agency becomes irrevocable.
- (c) When the authority has been partly exercised by the agent, it is irrevocable in particular with regard to obligations which arise from acts already done (Section 204).

## When Termination Takes Effect

Termination of an agency takes effect or is complete, as regards the agent when it becomes known to the agent. If the principal revokes the agent's authority, the revocation will take effect when the agent comes to know of it. As regards the third-parties, the termination takes effect when it comes to their knowledge (Section 208). Thus, if an agent whose authority has been terminated to his knowledge, enters into a contract with a third-party who deals with him *bona fide*, the contract will be binding on the principal as against the third-party. The termination of an agent's authority terminates the authority of the sub-agent appointed by the agent (Section 210).

The revocation of agency as regards the agent and as regards the principal takes effect at different points of time. Section 209 charges the agent with duty to protect the principal's interest where the principal dies or becomes of unsound mind. It provides that when an agency is terminated by the principal dying or becoming of unsound mind, the agent is bound to take, on behalf of the representatives of his late principal, all reasonable steps for the protection and preservation of the interest entrusted to him. So it is the duty of the agent to take all steps to protect the interest of his deceased principal on his death.

## JOINT VENTURE/ FOREIGN COLLABORATION/MULTINATIONAL AGREEMENTS

International business professionals use the term “modes of entry” to describe the different methods and approaches available to enter markets and conduct business in other countries. One mode of entry is the joint venture where two or more organizations join together in a cooperative effort to further their business goals. The joint venture is one of the most common and effective means of conducting business internationally. The joint venture documents and agreements are critical to the success of the venture. The joint venture agreement forms the basis of the understanding between and among the parties. It is relied upon to ensure that all parties understand their roles, rights, responsibilities, and remedies in the conduct of the venture. Organizations enter into joint ventures in good faith but closely scrutinize the joint venture documents if anything goes awry.

The importance of the documents and the purpose of this part is to cover, step by step, the critical elements to consider and include in joint venture agreements. Equity participation, for example, may or may not be as important as operational control. Technical participation in the venture may or may not be as important as the intellectual property rights that may result from the venture. A key to developing joint venture agreements is to determine goals and objectives in advance and ensure that the interests are reflected in the agreement.

Selection of good local partner is the key to success of any joint venture. Personal interviews with a prospective joint venture partner should be supplemented with proper due diligence. Once a partner is selected generally the parties highlighting the basis of the future joint venture agreement sign a memorandum of understanding or a letter of intent. Before signing the joint venture agreement, the terms should be thoroughly discussed to avoid any misunderstanding at a later stage. Negotiations require an understanding of the cultural and legal background of the parties.

It is difficult to prepare a set frame of the terms and conditions. The conditions may differ according to the requirements.

While drafting a foreign collaboration agreement, the following factors should be kept in mind:

- Capability of the collaborator and the requirements of the party are clearly indicated.
- Clear definitions of technical terms are given.
- Specify if the product shall be manufactured/sold on exclusive or non-exclusive basis.
- Terms and conditions regarding nature of technical know-how, disclosure of drawings, specifications and other documents, furnishing of technical information in respect of processes with flow charts etc., plant outlay list of equipment, machinery and tool with specification have to be provided.
- Provisions for making available the engineers and/or skilled workers of the collaborator on payment of expenses relating to their stay per diem etc. are given.
- Details regarding specification and quality of the product to be manufactured are given.
- Quality control and trademarks to be used are also specified.
- Responsibility of the collaborator in establishing or maintaining assembly plants should be clearly determined and provided for.
- If sub-contracting of the work is involved, clarify if there would be any restrictions.
- The rate of royalty, mode of calculation and payment etc. Also, make provision as to who will bear the taxes/cess on such payments.
- Use of information and industrial property rights should also be provided for in the agreement.
- A clause on force majeure should be included.
- A clause that the collaborating company has to train the personnel of Indian company within a specified period should be incorporated. The clause should also specify the terms and conditions of such assistance, place of training, period of training and fees payable.
- A comprehensive clause on arbitration containing a clear provision as to the kind of arbitrator and place of arbitration should be included.
- There should be provision in the agreement for payment of interest on delayed payments.

## E-CONTRACT

Electronic contracts are not paper based but rather in electronic form are born out of the need for speed, convenience and efficiency. In the electronic age, the whole transaction can be completed in seconds, with both parties simply affixing their digital signatures to an electronic copy of the contract. There was initially an apprehension amongst the legislatures to recognize this modern technology, but now many countries have enacted laws to recognize electronic contracts. The conventional law relating to contracts is not sufficient to address all the issues that arise in electronic contracts. The Information Technology Act, 2000 solves some of the peculiar issues that arise in the formation and authentication of electronic contracts

***As in every other contract, an electronic contract also requires the following necessary ingredients:***

- An offer needs to be made
- The offer needs to be accepted
- There has to be lawful consideration
- There has to be an intention to create legal relations
- The parties must be competent to contract
- There must be free and genuine consent
- The object of the contract must be lawful
- There must be certainty and possibility of performance.

### LESSON ROUND-UP

- A contract is an agreement enforceable at law, made between two or more persons, by which rights are acquired by one or more to acts or forbearances on the part of the other or others.
- Every promise and every set of promises, forming the consideration for each other, is an agreement.
- All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void.
- In a flaw contract There may be the circumstances under which a contract made under these rules may still be bad, because there is a flaw, vice or error somewhere. As a result of such a flaw, the apparent agreement is not a real agreement.
- Section 27 of the Indian Contract Act states that every agreement by which any one is restrained from exercising a lawful profession, trade or business of any kind, is, to that extent, void.
- The literal meaning of the word “wager” is a “bet”. Wagering agreements are nothing but ordinary betting agreements.
- An agreement not enforceable by law is void ab initio.
- A contingent contract is a contract to do or not to do something, if some event collateral to such contract, does or does not happen. Contract of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.
- A quasi-contract rests on the equitable principle that a person shall not be allowed to enrich himself unjustly at the expense of another. In truth, it is not a contract at all. It is an obligation which the law creates, in the absence of any agreement, when any person is in the possession of one person's money, or its equivalent, under such circumstances that in equity and good conscience he ought not to retain it, and which in justice and fairness belongs to another. It is the duty and not an agreement or intention which defines it.
- A contract is said to be discharged or terminated when the rights and obligations arising out of a contract are extinguished.
- Where a contract is broken, the injured party has several courses of action open to him. The appropriate remedy in any case will depend upon the subject-matter of the contract and the nature of the breach.

- A contract of indemnity is a contract by which one party promises to save the other party from loss caused to him by the conduct of the promisor himself, or by the conduct of any other person.
- A bailment is a transaction whereby one person delivers goods to another person for some purpose, upon a contract that they are, when the purpose is accomplished to be returned or otherwise disposed of according to the directions of the person delivering them.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define consideration and state its essential features.
2. "No consideration, no contract". Do you agree?
3. "The essence of every agreement is that there ought to be free consent on both the sides". Discuss.
4. How does a contract differ from agreements?
5. Write short notes on:
  - (a) Reciprocal promises.
  - (b) Substituted Agent.

## Lesson 21

# The Specific Relief Act, 1963

### ***Key Concepts One Should Know***

- Specific Relief
- Obligation
- Settlement
- Injunction

### ***Learning Objectives***

#### **To understand:**

- Specific Reliefs and Defense
- Specific Performance and Defense
- Unenforceable Contracts
- Know Decrees and Preventive Reliefs
- Public Private Partnerships
- Public Utilities Infrastructure Developments
- Specific Performance of Contract

### ***Regulatory Framework***

- The Specific Relief Act, 1963

### ***Lesson Outline***

- Introduction
- Recovery of Specific Immovable Property
- Suit by Person Dispossessed of Immovable Property
- Recovery of Specific Movable Property
- Specific Performance of Contract
- Contract not Specifically Enforce
- Power of the Court to Engage Experts
- Substituted Performance of Contract
- Special Provisions for Contract Relating to Infrastructure Project
- Special Court
- Expeditious Disposal of Suits
- Rectification of Instruments
- Rescission of Contract
- Declaratory Decree
- Preventive Relief
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

The law relating to specific relief in India is provided in the Specific Relief Act of 1963. The Specific Relief Act, 1963 was enacted to define and amend the law relating to certain kinds of specific relief.

The expression 'specific relief' means a relief in specie. It is a remedy which aims at the exact fulfillment of an obligation.

The Specific Relief Act, 1963 is not exhaustive. It does not consolidate the whole law on the subject. As the Preamble would indicate, it is an Act to define and amend the law relating to certain kinds of specific relief. It does not purport to lay down the law relating to specific relief in all its ramifications (AIR 1972 SC 1826)

There are other kinds of specific remedy provided for by other enactments e.g. the Transfer of Property Act deals with the specific remedies available to a mortgagor or mortgagee; the Partnership Act deals with the specific remedies like dissolution and accounts as between partners.

Under the Specific Relief Act, 1963, remedies have been divided as specific relief (Sections 5-35) and preventive relief (Sections 36-42). These are:

- (i) Recovering possession of property (Sections 5-8);
- (ii) Specific performance of contracts (Sections 9-25);
- (iii) Rectification of Instruments (Section 26);
- (iv) Rescission of contracts (Sections 27-30);
- (v) Cancellation of Instruments (Section 31-33);
- (vi) Declaratory decrees (Sections 34-35); and
- (vii) Injunctions (Sections 36-42).

## RECOVERING POSSESSION OF PROPERTY

### Recovery of specific immovable property

According to Section 5 of the Specific Relief Act, 1963 a person entitled to the possession of specific immovable property may recover it in the manner provided by the Code of Civil Procedure, 1908.

Such a suit is a general suit and the plaintiff has to prove that he has a better title.

### Suit by person dispossessed of immovable property

Section 6 provides that if any person is dispossessed without his consent of immovable property otherwise than in due course of law, he or any person through whom he has been in possession or any person claiming through him may, by suit, recover possession thereof, notwithstanding any other title that may be set up in such suit.

No suit under section 6 shall be brought—

- (a) after the expiry of six months from the date of dispossession; or
- (b) against the Government.

No appeal shall lie from any order or decree passed in any suit instituted under section 6, nor shall any review of any such order or decree be allowed.

Section 6 shall not bar any person from suing to establish his title to such property and to recover possession thereof.

Section 5 and 6 provide alternative remedies which are mutually exclusive.

## Recovery of specific movable property

Section 7 and 8 provide for recovery of specific movable properties.

As per Section 7 a person entitled to the possession of specific movable property may recover it in the manner provided by the Code of Civil Procedure, 1908.

*Explanation 1.*—A trustee may sue under this section for the possession of movable property to the beneficial interest in which the person for whom he is trustee is entitled.

*Explanation 2.*—A special or temporary right to the present possession of movable property is sufficient to support a suit under this section.

## Liability of person in possession, not as owner, to deliver to persons entitled to immediate possession

Section 8 provides that any person having the possession or control of a particular article of movable property, of which he is not the owner, may be compelled specifically to deliver it to the person entitled to its immediate possession, in any of the following cases:—

- (a) when the thing claimed is held by the defendant as the agent or trustee of the plaintiff;
- (b) when compensation in money would not afford the plaintiff adequate relief for the loss of the thing claimed;
- (c) when it would be extremely difficult to ascertain the actual damage caused by its loss;
- (d) when the possession of the thing claimed has been wrongfully transferred from the plaintiff.

*Explanation.*—Unless and until the contrary is proved, the court shall, in respect of any article of movable property claimed under clause (b) or clause (c) above, presume—

- (a) that compensation in money would not afford the plaintiff adequate relief for the loss of the thing claimed, or, as the case may be;
- (b) that it would be extremely difficult to ascertain the actual damage caused by its loss.

## SPECIFIC PERFORMANCE OF CONTRACTS

Relief by specific performance of contract is an equitable relief in cases of breach of contract.

### Defences respecting suits for relief based on contract

According to section 9, where any relief is claimed in respect of a contract, the person against whom the relief is claimed may plead by way of defence any ground which is available to him under any law relating to contracts.

The contract in question should be valid and enforceable.

### Specific performance in respect of contracts

As per section 10 of the Act, the specific performance of a contract shall be enforced by the court subject to the provisions contained in section 11(2), section 14 and section 16 of the Specific Relief Act, 1963.

### Cases in which specific performance of contracts connected with trusts enforceable

Section 11 provides that except as otherwise provided in this Act, specific performance of a contract shall be enforced when the act agreed to be done is in the performance wholly or partly of a trust.

A contract made by a trustee in excess of his powers or in breach of trust cannot be specifically enforced.

## Specific performance of part of contract

Section 12 deals with specific performance of a part of a contract. Sub-section (1) lays down the general principle that except as otherwise hereinafter provided in this section, the Court shall not direct the specific performance of a part of a contract. Sub-sections (2)-(4) lay down the exceptions to this general rule as follows:

- (i) Sub-section 2 says that where a party to a contract is unable to perform the whole of his part of it, but the part which must be left unperformed bears only a small proportion to the whole in value and admits of compensation in money, the Court may, at the suit of the either party, direct the specific performance of so much of the contract as can be performed and award compensation in money for the deficiency.

A contracts to sell B a piece of land consisting of 100 *bighas*. It turns out that 98 *bighas* of the land belongs to A and the two remaining *bighas* to a stranger, who refuses to part with them. The two *bighas* are not necessary for the use of enjoyment of the 98 *bighas*, nor so important for such use or enjoyment that the loss of them may not be made in goods or in money. A may be directed at the suit of B to convey to B the 98 *bighas* and to make compensation to him. For not conveying the two remaining *bighas*; B may be directed at the suit of A, to pay to A, on receiving the conveyance and possession of the land, the stipulated purchase money less the sum awarded as compensation for the deficiency.

- (ii) Sub-section 3 lays down that where a party to a contract is unable to perform the whole of his part of it, and the part which must be left unperformed either (a) forms a considerable part of the whole, though admitting of compensation in money; or (b) does not admit of compensation in money; he is not entitled to obtain a decree for specific performance; but the Court may, at the suit of the other party, direct the party in default to perform specifically so much of his part of the contract as he can perform, if the party (i) in a case falling under clause (a), pays or has paid the agreed consideration for the whole of the contract reduced by the consideration for the part which must be left unperformed and in a case falling under clause (b), pays or has paid the consideration for the whole of the contract without any abatement, and (ii) in either case, relinquishes all claims to the performance of the remaining part of the contract and all rights to compensation, either for the deficiency or for the loss or damage sustained by him through the default of the defendant.

For example, A contracts to sell B a piece of land consisting of 100 *bighas* for Rs. 1,00,000. It turns out that only 50 *bighas* of land belong to A. 50 *bighas* are substantial part of the contract. A cannot demand specific performance of the contract but B can demand specific performance to get 50 *bighas* of land from A by paying the full consideration i.e. Rs. 1,00,000.

- (iii) Sub-section 4 lays down that when a part of a contract which taken by itself, can and ought to be specifically performed, stands on a separate and independent footing from another part of the same contract which cannot or ought not to be specifically performed, the Court may direct specific performance of the former part.

For the purposes of this section, a party to the contract shall be deemed to be unable to perform the whole of his part of it, if a portion of its subject matter existing at the date of the contract has ceased to exist at the time of its performance.

## Rights of purchaser or lessee against person with no title or imperfect title

Section 13 lays down the rights of a purchaser or lessee against the seller or lessor with no title or imperfect title. It lays down that where a person contracts to sell or let certain immovable property having no title or only an imperfect title, the purchaser or lessee (subject to the other provisions of this Chapter), has the following rights, namely:—

- (a) if the vendor or lessor has subsequently to the contract acquired any interest in the property, the purchaser or lessee may compel him to make good the contract out of such interest;
- (b) where the concurrence of other person is necessary for validating the title, and they are bound to concur at the request of the vendor or lessor, the purchaser or lessee may compel him to procure such concurrence, and when a conveyance by other persons is necessary to validate the title and they are bound to convey at the request of the vendor or lessor, the purchaser or lessee may compel him to procure such conveyance;

- (c) where the vendor professes to sell unencumbered property, but the property is mortgaged for an amount not exceeding the purchase money and the vendor has in fact only a right to redeem it, the purchaser may compel him to redeem the mortgage and to obtain a valid discharge, and, where necessary, also a conveyance from the mortgagee;
- (d) where the vendor or lessor sues for specific performance of the contract and the suit is dismissed on the ground of his want of title or imperfect title, the defendant has a right to a return of his deposit, if any, with interest thereon, to his costs of the suit, and to a lien for such deposit, interest and costs on the interest, if any, of the vendor or lessor in the property which is the subject-matter of the contract.

Above provisions shall also apply, as far as may be, to contracts for the sale or hire of movable property.

### **Contracts not specifically enforceable**

Section 14 lays down the contracts which cannot be specifically enforced. The following contracts cannot be specifically enforced, namely:—

- (a) where a party to the contract has obtained substituted performance of contract in accordance with the provisions of section 20;
- (b) a contract, the performance of which involves the performance of a continuous duty which the court cannot supervise;
- (c) a contract which is so dependent on the personal qualifications of the parties that the court cannot enforce specific performance of its material terms; and
- (d) a contract which is in its nature determinable.

### **Power of court to engage experts**

Section 14A (1) provides that without prejudice to the generality of the provisions contained in the Code of Civil Procedure, 1908, in any suit under this Act, where the court considers it necessary to get expert opinion to assist it on any specific issue involved in the suit, it may engage one or more experts and direct to report to it on such issue and may secure attendance of the expert for providing evidence, including production of documents on the issue.

Section 14A (2) lays down that the court may require or direct any person to give relevant information to the expert or to produce, or to provide access to, any relevant documents, goods or other property for his inspection.

As per Section 14A (3) the opinion or report given by the expert shall form part of the record of the suit; and the court, or with the permission of the court any of the parties to the suit, may examine the expert personally in open court on any of the matters referred to him or mentioned in his opinion or report, or as to his opinion or report, or as to the manner in which he has made the inspection.

According to Section 14A (4) the expert shall be entitled to such fee, cost or expense as the court may fix, which shall be payable by the parties in such proportion, and at such time, as the court may direct.”

### **Who may obtain specific performance**

Section 15 lays down that the specific performance of a contract may be obtained by—

- (a) any party thereto;
- (b) the representative in interest or the principal, of any party thereto:

It may be noted that where the learning, skill, solvency or any personal quality of such party is a material ingredient in the contract, or where the contract provides that his interest shall not be assigned, his representative in interest or his principal shall not be entitled to specific performance of the contract, unless such party has already performed his part of the contract, or the performance thereof by his representative in interest, or his principal, has been accepted by the other party.

- (c) where the contract is a settlement on marriage, or a compromise of doubtful rights between members of the same family, any person beneficially entitled thereunder;

- (d) where the contract has been entered into by a tenant for life in due exercise of a power, the remainder man;
- (e) a reversioner in possession, where the agreement is a covenant entered into with his predecessor in title and the reversioner is entitled to the benefit of such covenant;
- (f) a reversioner in remainder, where the agreement is such a covenant, and the reversioner is entitled to the benefit thereof and will sustain material injury by reason of its breach;
- (fa) when a limited liability partnership has entered into a contract and subsequently becomes amalgamated with another limited liability partnership, the new limited liability partnership which arises out of the amalgamation;
- (g) when a company has entered into a contract and subsequently becomes amalgamated with another company, the new company which arises out of the amalgamation;
- (h) when the promoters of a company have, before its incorporation, entered into a contract for the purposes of the company, and such contract is warranted by the terms of the incorporation, the company;

Provided that the company has accepted the contract and has communicated such acceptance to the other party to the contract.

### Personal bars to relief

According to Section 16 Specific performance of a contract cannot be enforced in favour of a person—

- (a) who has obtained substituted performance of contract under section 20; or
- (b) who has become incapable of performing, or violates any essential term of, the contract that on his part remains to be performed, or acts in fraud of the contract, or wilfully acts at variance with, or in subversion of, the relation intended to be established by the contract; or
- (c) who fails to prove that he has performed or has always been ready and willing to perform the essential terms of the contract which are to be performed by him, other than terms of the performance of which has been prevented or waived by the defendant.

*Explanation.*—For the purposes of clause (c) above,-

- (i) where a contract involves the payment of money, it is not essential for the plaintiff to actually tender to the defendant or to deposit in court any money except when so directed by the court;
- (ii) the plaintiff must prove performance of, or readiness and willingness to perform, the contract according to its true construction.

### Contract to sell or let property by one who has no title, not specifically enforceable

As per Section 17, a contract to sell or let any immovable property cannot be specifically enforced in favour of a vendor or lessor—

- (a) who, knowing himself not to have any title to the property, has contracted to sell or let the property;
- (b) who, though he entered into the contract believing that he had a good title to the property, cannot at the time fixed by the parties or by the court for the completion of the sale or letting, give the purchaser or lessee a title free from reasonable doubt.

The above provisions shall also apply, as far as may be, to contracts for the sale or hire of movable property.

### Non-enforcement except with variation

Where a plaintiff seeks specific performance of a contract in writing, to which the defendant sets up a variation, the plaintiff cannot obtain the performance sought, except with the variation so set up, in the following cases, namely:—

- (a) where by fraud, mistake of fact or misrepresentation, the written contract of which performance is sought is in its terms or effect different from what the parties agreed to, or does not contain all the terms agreed to between the parties on the basis of which the defendant entered into the contact;

- (b) where the object of the parties was to produce a certain legal result which the contract as framed is not calculated to produce;
- (c) where the parties have, subsequently to the execution of the contract, varied its terms.

### Relief against parties and persons claiming under them by subsequent title

Section 19 lays down that specific performance of a contract may be enforced against—

- (a) either party thereto;
- (b) any other person claiming under him by a title arising subsequently to the contract, except a transferee for value who has paid his money in good faith and without notice of the original contract;
- (c) any person claiming under a title which, though prior to the contract and known to the plaintiff, might have been displaced by the defendant;
- (ca) when a limited liability partnership has entered into a contract and subsequently becomes amalgamated with another limited liability partnership, the new limited liability partnership which arises out of the amalgamation.
- (d) when a company has entered into a contract and subsequently becomes amalgamated with another company, the new company which arises out of the amalgamation;
- (e) when the promoters of a company have, before its incorporation, entered into a contract for the purpose of the company and such contract is warranted by the terms of the incorporation, the company. It may be noted that the company has accepted the contract and communicated such acceptance to the other party to the contract.

### Substituted performance of contracts, etc.

Section 20(1) lays down that without prejudice to the generality of the provisions contained in the Indian Contract Act, 1872, and, except as otherwise agreed upon by the parties, where the contract is broken due to non-performance of promise by any party, the party who suffers by such breach shall have the option of substituted performance through a third party or by his own agency, and, recover the expenses and other costs actually incurred, spent or suffered by him, from the party committing such breach.

According to section 20(2), no substituted performance of contract under above sub-section (1) shall be undertaken unless the party who suffers such breach has given a notice in writing, of not less than thirty days, to the party in breach calling upon him to perform the contract within such time as specified in the notice, and on his refusal or failure to do so, he may get the same performed by a third party or by his own agency.

However, the party who suffers such breach shall not be entitled to recover the expenses and costs under sub-section (1) unless he has got the contract performed through a third party or by his own agency.

Section 20(3) provides that where the party suffering breach of contract has got the contract performed through a third party or by his own agency after giving notice under sub-section (1), he shall not be entitled to claim relief of specific performance against the party in breach.

Section 20 shall not prevent the party who has suffered breach of contract from claiming compensation from the party in breach.

### Special provisions for contract relating to infrastructure project

Section 20A lays down Special provisions for contract relating to infrastructure project. According to section 20A(1), No injunction shall be granted by a court in a suit under this Act involving a contract relating to an infrastructure project specified in the Schedule, where granting injunction would cause impediment or delay in the progress or completion of such infrastructure project.

As per Section 20A (2), the Central Government may, depending upon the requirement for development of infrastructure projects, and if it considers necessary or expedient to do so, by notification in the Official Gazette, amend the Schedule relating to any Category of projects or Infrastructure Sub-Sectors.

Section 20A(3) provides that every notification issued under the Act by the Central Government shall be laid, as soon as may be after it is issued, before each House of Parliament, while it is in session, for a total period of thirty days which may be comprised in one session or in two or more successive sessions, and if, before the expiry of the session immediately following the session or the successive sessions aforesaid, both Houses agree in making any modification in the notification or both Houses agree that the notification should not be made, the notification shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that notification.

### Special Courts

Section 20B empowers the State Government, in consultation with the Chief Justice of the High Court, shall designate, by notification published in the Official Gazette, one or more Civil Courts as Special Courts, within the local limits of the area to exercise jurisdiction and to try a suit under this Act in respect of contracts relating to infrastructure projects.

### Expedited disposal of suits

Section 20C states that notwithstanding anything contained in the Code of Civil Procedure, 1908, a suit filed under the provisions of this Act shall be disposed of by the court within a period of twelve months from the date of service of summons to the defendant:

The above stated period may be extended for a further period not exceeding six months in aggregate after recording reasons in writing for such extension by the court.

### Power to award compensation in certain cases

Under section 21 of the Specific Relief Act, 1963, the Court is empowered to award compensation in certain cases. They are as follows:

1. In a suit for specific performance of a contract, the plaintiff may also claim compensation for its breach, in addition to, such performance.
2. If, in any such suit, the court decides that specific performance ought not to be granted, but that there is a contract between the parties which has been broken by the defendant, and that the plaintiff is entitled to compensation for that breach, it shall award him such compensation accordingly.
3. If, in any such suit, the court decides that specific performance ought to be granted, but that it is not sufficient to satisfy the justice of the case, and that some compensation for breach of the contract should also be made to the plaintiff, it shall award him such compensation accordingly.
4. In determining the amount of any compensation awarded under this section, the court shall be guided by the principles specified in section 73 of the Indian Contract Act, 1872.
5. No compensation shall be awarded under this section unless the plaintiff has claimed such compensation in his plaint. However, where the plaintiff has not claimed any such compensation in the plaint, the court shall, at any stage of the proceeding, allow him to amend the plaint on such terms as may be just, for including a claim for such compensation.

Even if the contract has become incapable of specific performance does not preclude the court from exercising the jurisdiction conferred by this section.

### Power to grant relief for possession, partition, refund of earnest money, etc

Section 22 gives power to grant relief for possession, partition, refund of earnest money, etc. Under section 22(1) any person suing for the specific performance of a contract for the transfer of immovable property may, in an appropriate case, ask for—

- (a) possession, or partition and separate possession, of the property in addition to such performance; or

- (b) any other relief to which he may be entitled, including the refund of any earnest money or deposit paid or made by him, in case his claim for specific performance is refused.

No relief under clause (a) or clause (b) of sub-section (1) shall be granted by the court unless it has been specifically claimed. Where the plaintiff has not claimed any such relief in the plaint, the court shall, at any stage of the proceeding, allow him to amend the plaint on such terms as may be just for including a claim for such relief.

The power of the court to grant relief under clause (b) of sub-section (1) shall be without prejudice to its powers to award compensation under section 21.

### **Liquidation of damages not a bar to specific performance**

According to Section 23, a contract, otherwise proper to be specifically enforced, may be so enforced, though a sum be named in it as the amount to be paid in case of its breach and the party in default is willing to pay the same, if the court, having regard to the terms of the contract and other attending circumstances, is satisfied that the sum was named only for the purpose of securing performance of the contract and not for the purpose of giving to the party in default an option of paying money in lieu of specific performance. When enforcing specific performance, the court shall not also decree payment of the sum so named in the contract.

### **Bar of suit for compensation for breach after dismissal of suit for specific performance**

Section 24 provides that the dismissal of a suit for specific performance of a contract or part thereof shall bar the plaintiff's right to sue for compensation for the breach of such contract or part, as the case may be, but shall not bar his right to sue for any other relief to which he may be entitled, by reason of such breach.

### **Enforcement of awards and directions to execute settlements**

Section 25 provides that the provisions of Chapter II shall apply to awards to which the Arbitration and Conciliation Act, 1996 does not apply and to directions in a will or codicil to execute particular settlement.

### **Rectification of Instruments**

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Rectification means correction of an error in an instrument in order to give effect to the real intention of the parties. Section 26 of the Specific Relief Act, 1963 contains the law as to rectification of instruments.

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Section 26 (1) provides that when, through fraud or a mutual mistake of the parties a contract or other instrument in writing not being the articles of association of a company to which the Companies Act, applies does not express their real intention, then—

- (a) either party or his representative in interest may institute a suit to have the instrument rectified; or
- (b) the plaintiff may, in any suit in which any right arising under the instrument is in issue, claim in his pleading that the instrument be rectified; or
- (c) a defendant in any such suit as is referred to in clause (b), may, in addition to any other defence open to him, ask for rectification of the instrument.

If, in any suit in which a contract or other instrument is sought to be rectified, the court finds that the instrument, through fraud or mistake, does not express the real intention of the parties, the court may in its discretion, direct rectification of the instrument so as to express that intention, so far as this can be done without prejudice to rights acquired by third persons in good faith and for value.

A contract in writing may first be rectified, and then if the party claiming rectification has so prayed in his pleading and the court thinks fit, may be specifically enforced.

Relief for the rectification of an instrument shall not be granted to any party under this section unless it has been specifically claimed. Where a party has not claimed any such relief in his pleading, the court shall, at any stage of the proceeding, allow him to amend the pleading on such terms as may be just for including such claim.

The term 'instrument' has been defined under Section 2(14) of the Indian Stamp Act, 1899. According to the definition, 'instrument' includes every document by which any right or liability is, or purports to be, created, transferred, limited, extended, extinguished or recorded:

## RESCISSON OF CONTRACTS (SECTIONS 27-30)

### Section 27 deals with when rescission may be adjudged or refused

"Rescission" means putting an end to a contract which is still operative and making it null and void *ab initio*. It does not apply to void contracts.

Section 27(1) states that any person interested in a contract may sue to have it rescinded, and such rescission may be adjudged by the court in any of the following cases, namely:—

- (a) where the contract is voidable or terminable by the plaintiff;
- (b) where the contract is unlawful for causes not apparent on its face and the defendant is more to blame than the plaintiff.

As per Section 27(2) the court may refuse to rescind the contract—

- (a) where the plaintiff has expressly or impliedly ratified the contract; or
- (b) where, owing to the change of circumstances which has taken place since the making of the contract (not being due to any act of the defendant himself), the parties cannot be substantially restored to the position in which they stood when the contract was made; or
- (c) where third parties have, during the subsistence of the contract, acquired rights in good faith without notice and for value; or
- (d) where only a part of the contract is sought to be rescinded and such part is not severable from the rest of the contract.

The 'contract' in this section, in relation to the territories to which the Transfer of Property, 1882 does not extend, means a contract in writing.

### Rescission in certain circumstances of contracts for the sale or lease of immovable property, the specific performance of which has been decreed

Section 28(1) provides that where in any suit a decree for specific performance of a contract for the sale or lease of immovable property has been made and the purchaser or lessee does not, within the period allowed by the decree or such further period as the court may allow, pay the purchase money or other sum which the court has ordered him to pay, the vendor or lessor may apply in the same suit in which the decree is made, to have the contract rescinded and on such application the court may, by order, rescind the contract either so far as regards the party in default or altogether, as the justice of the case may require.

As per Section 28 (2), where a contract is rescinded under sub-section (1), the Court—

- (a) shall direct the purchaser or the lessee, if he has obtained possession of the property under the contract, to restore such possession to the vendor or lessor; and
- (b) may direct payment to the vendor or lessor of all the rents and profits which have accrued in respect of the property from the date on which possession was so obtained by the purchaser or lessee until restoration of possession to the vendor or lessor; and, if the justice of the case so requires, the refund of any sum paid by the vendee or the lessee as earnest money or deposit in connection with the contract.

According to Section 28(3), if the purchase or lessee pays the purchase money or other sum which he is ordered to pay under the decree within the period referred to in sub-section (1), the court may, on application made in the same suit, award the purchaser or lessee such further relief as he may be entitled to, including in appropriate cases all or any of the following reliefs, namely:—

- (a) the execution of a proper conveyance or lease by the vendor or lessor;
- (b) the delivery of possession, or partition and separate possession, of the property on the execution of such conveyance or lease.

Separate suit in respect of any relief which may be claimed shall not lie at the instance of a vendor, purchaser, lessor or lessee, as the case may be. The costs of any proceedings under this section shall be in the discretion of the court.

### Alternative prayer for rescission in suit for specific performance

Section 29 of the Act, provides that a plaintiff instituting a suit for the specific performance of a contract in writing may pray in the alternative that, if the contract cannot be specifically enforced, it may be rescinded and delivered up to be cancelled; and the court, if it refuses to enforce the contract specifically, may direct it to be rescinded and delivered up accordingly.

### Court may require parties rescinding to do equity

According to Section 30, on adjudging the rescission of a contract, the court may require the party to whom such relief is granted to restore, so far as may be, any benefit which he may have received from the other party and to make any compensation to him which justice may be require.

### Cancellation of Instruments (Sections 31-33)

Section 31 dealing with when cancellation may be ordered. Section 31(1) provides that any person against whom a written instrument is void or voidable, and who has reasonable apprehension that such instrument, if left outstanding may cause him serious injury, may sue to have it adjudged void or voidable; and the court may, in its discretion, so adjudge it and order it to be delivered up and cancelled.

As per Section 30(2), if the instrument has been registered under the Indian Registration Act, 1908, the court shall also send a copy of its decree to the officer in whose office the instrument has been so registered; and such officer shall note on the copy of the instrument contained in his books the fact of its cancellation.

### What instruments may be partially cancelled

According to Section 32 of the Act, where an instrument is evidence of different rights or different obligations, the court may, in a proper case, cancel it in part and allow it to stand for the residue.

### Power to require benefit to be restored or compensation to be made when instrument is cancelled or is successfully resisted as being void or voidable

Section 33 provides that on adjudging the cancellation of an instrument, the court may require the party to whom such relief is granted, to restore, so far as may be any benefit which he may have received from the other party and to make any compensation to him which justice may require.

Where a defendant successfully resists any suit on the ground—

- (a) that the instrument sought to be enforced against him in the suit is voidable, the court may if the defendant has received any benefit under the instrument from the other party, require him to restore, so far as may be, such benefit to that party or to make compensation for it;
- (b) that the agreement sought to be enforced against him in the suit is void by reason of his not having been competent to contract under section 11 of the Indian Contract Act, 1872, the court may, if the defendant has received any benefit under the agreement from the other party, require him to restore, so far as may be, such benefit to that party, to the extent to which he or his estate has benefited thereby

### Declaratory Decrees (Sections 34-35)

A declaratory decree is a decree whereby any right as to any property or the legal character of a person is judicially ascertained.

The Supreme Court in *State of Madhya Pradesh v. Mangilal Sharma, 1997 (7) SCALE 783*, held that a declaratory decree merely declares the right of the decreeholder vis-a-vis the judgement debtor and does not in terms direct the judgement debtor to do or refrain from doing any particular act or thing. It cannot be executed as it only declares the rights of the decree-holder qua the judgement debtor and does not, in terms, direct him to do or refrain from doing any particular act or thing.

### Discretion of court as to declaration of status or right

Section 34 lays down that any person entitled to any legal character, or to any right as to any property, may institute a suit against any person denying, or interested to deny, his title to such character or right, and the court may in its discretion make therein a declaration that he is so entitled, and the plaintiff need not in such suit ask for any further relief:

It may be noted that court shall not make any such declaration where the plaintiff, being able to seek further relief than a mere declaration of title, omits to do so.

### Effect of declaration

According to Section 35 of the Act, a declaration made is binding only on the parties to the suit, persons claiming through them respectively, and, where any of the parties are trustees, on the persons for whom, if in existence at the date of the declaration, such parties would be trustees.

### Preventive Relief (Sections 36-41)

Part III of the Specific Relief Act, 1963 grants specific relief called Preventive Relief i.e., preventing a party from doing that which he is under an obligation not to do.

**Injunction:** Preventive relief is granted at the discretion of the court by way of an injunction.

An injunction is a specific order of the Court forbidding the commission of a wrong threatened or the continuance of a wrongful course of action already begun, or in some cases (when it is called a 'mandatory injunction') commanding active restitution of the former state of things.

Lord Halsbury defines injunction as "a judicial process whereby a party is ordered to refrain from doing or to do a particular act or thing".

The main difference between an injunction and specific performance is that the remedy in case of an injunction is generally directed to prevent the violation of a negative act and therefore deals not only with contracts but also with torts and many other subjects of purely equitable one, whereas specific performance is directed to compelling performance of an active duty.

It is known as a "judicial process by which one, who has invaded or is threatening to invade the rights (legal or equitable) of another is restrained from continuing or commencing such wrongful act. Injunction is the most ordinary form of preventive relief. For the effective administration of justice, this power to prevent and to restrain is absolutely necessary.

#### Characteristics of an injunction

An injunction has three characteristic features;

- It is a judicial process.
- The object of this judicial process is to restrain or to prevent.
- The act restrained or prevented is a wrongful act. An injunction acts or operates always in personam.

If the wrongful act has already taken place, the injunction prevents its repetition. If it is merely threatened, the threat is prevented from being executed.

## Injunctions Generally

As per Section 36 of the Act, preventive relief is granted at the discretion of the court by injunction, temporary or perpetual.

### Temporary and perpetual injunctions

(1) Temporary injunctions are such as are to continue until a specific time, or until the further order of the court, and they may be granted at any stage of a suit, and are regulated by the Code of Civil Procedure, 1908.

(2) A perpetual injunction can only be granted by the decree made at the hearing and upon the merits of the suit; the defendant is thereby perpetually enjoined from the assertion of a right, or from the commission of an act, which would be contrary to the rights of the plaintiff.

## Perpetual Injunctions

Specific performance is decreed to compel the performance of an active duty, while injunction is decreed to prevent the violation of a negative duty. Normally, the former deals with contracts, while the latter with torts and other subjects of equitable nature. If a contract is positive in its nature, it calls for the relief of specific performance, on the other hand, if it is negative in its nature, it calls for relief of injunction.

The principle governing the award of injunction as a mode of enforcement of contracts is similar to that of specific performance. This is clearly borne out by Section 38(2) of the Act. Thus, the enforcement of a contract is governed by both specific relief and injunction. "The jurisdiction of equity to grant such injunction is substantially coexistent with its jurisdiction to compel a specific performance". But still their fields of operation are separate from each other. While a promise to do is enforced by specific performance, a promise to forbear is enforced by injunction. Section 41(e) further provides that contract which will not be affirmatively enforced by a decree of specific performance, will not be negatively enforced by issuing an injunction. The only exception to this rule is found in Section 42.

### Perpetual injunction when granted

According to Section 38, a perpetual injunction may be granted to the plaintiff to prevent the breach of an obligation existing in his favour, whether expressly or by implication. When any such obligation arises from contract, the court shall be guided by the rules and provisions contained in Chapter II.

When the defendant invades or threatens to invade the plaintiff's right to, or enjoyment of, property, the court may grant a perpetual injunction in the following cases, namely:—

- (a) where the defendant is trustee of the property for the plaintiff;
- (b) where there exists no standard for ascertaining the actual damage caused, or likely to be caused, by the invasion;
- (c) where the invasion is such that compensation in money would not afford adequate relief;
- (d) where the injunction is necessary to prevent a multiplicity of judicial proceedings.

## Mandatory injunctions

As per Section 39 of the Act, when, to prevent the breach of an obligation, it is necessary to compel the performance of certain acts which the court is capable of enforcing, the court may in its discretion grant an injunction to prevent the breach complained of, and also to compel performance of the requisite acts.

### Damages in lieu of, or in addition to, injunction

Section 40 dealing with damages in lieu of, or in addition to, injunction. It states that the plaintiff in a suit for perpetual injunction under section 38, or mandatory injunction under section 39, may claim damages either in addition to, or in substitution for, such injunction and the court may, if it thinks fit, award such damages.

Relief for damages shall not be granted unless the plaintiff has claimed such relief in his plaint. Where no such damages have been claimed in the plaint, the court shall, at any stage of the proceedings, allow the plaintiff to amend the plaint on such terms as may be just for including such claim.

The dismissal of a suit to prevent the breach of an obligation existing in favour of the plaintiff shall bar his right to sue for damages for such breach.

### Injunction when refused

***Section 41 gives a list of cases when injunction cannot be granted. It says that an injunction cannot be granted –***

- (a) to restrain any person from prosecuting a judicial proceeding pending at the institution of the suit in which the injunction is sought, unless such restraint is necessary to prevent a multiplicity of proceedings;
- (b) to restrain any person from instituting or prosecuting any proceeding in a court not subordinate to that from which the injunction is sought;
- (c) to restrain any person from applying to any legislative body;
- (d) to restrain any person from instituting or prosecuting any proceeding in a criminal matter;
- (e) to prevent the breach of a contract the performance of which would not be specifically enforced;
- (f) to prevent, on the ground of nuisance, an act of which it is not reasonably clear that it will be a nuisance;
- (g) to prevent a continuing breach in which the plaintiff has acquiesced;
- (h) when equally efficacious relief can certainly be obtained by any other usual mode of proceeding except in case of breach of trust;
- (ha) if it would impede or delay the progress or completion of any infrastructure project or interfere with the continued provision of relevant facility related thereto or services being the subject matter of such project.
- (i) when the conduct of the plaintiff or his agents has been such as to disentitle him to be the assistance of the court;
- (j) when the plaintiff has no personal interest in the matter.

### Injunction to perform negative agreement

Section 42 of the Act provides that notwithstanding anything contained in section 41(e), where a contract comprises an affirmative agreement to do a certain act, coupled with a negative agreement, express or implied, not to do a certain act, the circumstance that the court is unable to compel specific performance of the affirmative agreement shall not preclude it from granting an injunction to perform the negative agreement. It may be noted that the plaintiff has not failed to perform the contract so far as it is binding on him.

| <p style="text-align: center;"><b>THE SCHEDULE</b><br/> <b>[sections 20A and 41 (ha)]</b></p> <p style="text-align: center;"><b>Category of projects and Infrastructure Sub-Sectors</b></p> |   |   |
|---|---|---|
| <b>Sl. No.</b>  | <b>Category</b>                             | <b>Infrastructure Sub-Sectors</b>   |
| <b>1</b>  | <b>Transport</b>                            | <ul style="list-style-type: none"> <li>(a) Road and bridges</li> <li>(b) Ports (including Capital Dredging)</li> <li>(c) Shipyards (including a floating or land-based facility with the essential features of waterfront, turning basin, berthing and docking facility, slipways or ship lifts, and which is self-sufficient for carrying on shipbuilding/repair/breaking activities)</li> <li>(d) Inland Waterways</li> <li>(e) Airports</li> <li>(f) Railway Track, tunnels, viaducts, bridges, terminal infrastructure including stations and adjoining commercial infrastructure</li> <li>(g) Urban Public Transport (except rolling stock in case of urban road transport)</li> </ul> |
| <b>2</b>  | <b>Energy</b>                               | <ul style="list-style-type: none"> <li>(a) Electricity Generation</li> <li>(b) Electricity Transmission</li> <li>(c) Electricity Distribution</li> <li>(d) Oil pipelines</li> <li>(e) Oil/Gas/Liquefied Natural Gas (LNG) storage facility (including strategic storage of crude oil)</li> <li>(f) Gas pipelines (including city gas distribution network)</li> </ul>   |
| <b>3</b>  | <b>Water and Sanitation</b>                 | <ul style="list-style-type: none"> <li>(a) Solid Waste Management</li> <li>(b) Water supply pipelines</li> <li>(c) Water treatment plants</li> <li>(d) Sewage collection, treatment and disposal system</li> <li>(e) Irrigation (dams, channels, embankments, etc.)</li> <li>(f) Storm Water Drainage System</li> <li>(g) Slurry pipelines</li> </ul>   |
| <b>4</b>  | <b>Communication</b>                        | <ul style="list-style-type: none"> <li>(a) Telecommunication (Fixed network including opticfibre/wire/cable networks which provide broadband/internet)</li> <li>(b) Telecommunication towers</li> <li>(c) Telecommunications and Telecom Services</li> </ul>  |
| <b>5</b>  | <b>Social and Commercial Infrastructure</b> | <ul style="list-style-type: none"> <li>(a) Education Institutions (capital stock)</li> <li>(b) Sports infrastructure (including provision of Sports Stadia and Infrastructure for Academies for Training/ Research in Sports and Sports-relating activities)</li> <li>(c) Hospitals (capital stock including Medical Colleges, Para Medical Training Institutes and Diagnostic Centres)</li> <li>(d) Tourism infrastructure viz.(i) three-star or higher category classified hotels located outside cities with population of more than one million; (ii) ropeways and cable cars</li> </ul>  |

|  |  |   |
|--|--|---|
|  |  | <p>(e) Common infrastructure for industrial parks and other parks with industrial activity such as food parks, textile parks, Special Economic Zones, tourism facilities and agriculture markets</p> <p>(f) Post-harvest storage infrastructure for agriculture and horticulture produce including cold storage</p> <p>(g) Terminal markets</p> <p>(h) Soil-testing laboratories</p> <p>(i) Coldchain (including cold room facility for farm level pre-cooling, for preservation or storage of agriculture and allied produce, marine products and meat)</p> <p>(j) Affordable Housing (including a housing project using at least 50% of the Floor Area Ratio (FAR)/ Floor Space Index (FSI) for dwelling units with carpet area of not more than 60 square meters</p> <p>Explanation.—For the purposes of this sub-clause, the term “carpet area” shall have the same meaning as assigned to it in clause (k) of section 2 of the Real Estate (Regulation and Development) Act, 2016.</p> |
|--|--|---|

### LESSON ROUND UP

- The Specific Relief Act, 1963 was enacted to define and amend the law relating to certain kinds of specific relief. It contains provisions, inter alia, specific performance of contracts, contracts not specifically enforceable, parties who may obtain and against whom specific performance may be obtained, etc.
- The tremendous economic development since the enactment of the Act have brought in enormous commercial activities in India including foreign direct investments, public private partnerships, public utilities infrastructure developments, etc.; which have prompted extensive reforms in the related laws to facilitate enforcement of contracts, settlement of disputes in speedy manner.
- It has been felt that the Specific Relief Act is not in tune with the rapid economic growth happening in our country and the expansion of infrastructure activities that are needed for the overall development of the country, Parliament enacted Specific Relief (Amendment) Act, 2018 and came into effect from 01 October, 2018.
- Section 14 lays down the contracts which cannot be specifically enforced, namely:—(a) where a party to the contract has obtained substituted performance of contract in accordance with the provisions of section 20; (b) a contract, the performance of which involves the performance of a continuous duty which the court cannot supervise; (c) a contract which is so dependent on the personal qualifications of the parties that the court cannot enforce specific performance of its material terms; and (d) a contract which is in its nature determinable.
- Where the court considers it necessary to get expert opinion to assist it on any specific issue involved in the suit, it may engage one or more experts and direct to report to it on such issue and may secure attendance of the expert for providing evidence, including production of documents on the issue.
- Where the contract is broken due to non-performance of promise by any party, the party who suffers by such breach shall have the option of substituted performance through a third party or by his own agency, and, recover the expenses and other costs actually incurred, spent or suffered by him, from the party committing such breach.
- Injunction shall not be granted by a court in a suit under this Act involving a contract relating to an infrastructure project specified in the Schedule, where granting injunction would cause impediment or delay in the progress or completion of such infrastructure project.

- State Government, in consultation with the Chief Justice of the High Court, shall designate, by notification published in the Official Gazette, one or more Civil Courts as Special Courts, within the local limits of the area to exercise jurisdiction and to try a suit under Specific Relief Act in respect of contracts relating to infrastructure projects.
- A suit filed shall be disposed of by the court within a period of twelve months from the date of service of summons to the defendant. The period may be extended for a further period not exceeding six months in aggregate after recording reasons in writing for such extension by the court.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Explain whether specific performance of a part of contract is allowed.
2. State the exception to a specific performance.
3. Who may sue for Specific Performance?
4. Discuss recovery of possession of property under the Specific Relief Act, 1963.
5. State the persons against whom Specific Performance available.



## Lesson 22

# Sale of Goods Act, 1930

### ***Key Concepts One Should Know***

- Sale
- Goods
- Future goods
- Contract of Sale
- Agreement to Sell
- Doctrine of Caveat Emptor

### ***Learning Objectives***

#### **To understand:**

- Essentials of a Contract of Sale
- Sale of Property
- Sale Distinguished from Agreement to Sell
- Bailment
- Conditions and Warranties
- Doctrine of Caveat Emptor
- Mutual Consent
- Lawful Object

### ***Regulatory Framework***

- Sale of Goods Act, 1930

### ***Lesson Outline***

- Essentials of a Contract of Sale
- Sale Distinguished from Agreement to Sell
- Bailment
- Contract for Work and Labour and Hire Purchase
- Conditions and Warranties
- Doctrine of Caveat Emptor
- Performance of the Contract of Sale
- LESSON ROUND-UP
- TEST YOURSELF

Sale of Goods Act is one of very old mercantile law. Sale of Goods is one of the special types of contract. Initially, this was part of Indian Contract Act itself. Later, this was deleted in Contract Act, and separate Sale of Goods Act was passed in 1930. Sale of Goods Act is complimentary to Contract Act. Basic provisions of Contract Act apply to contract of Sale of Goods Act also. Basic requirements of contract i.e. Offer and acceptance, legally enforceable agreement, mutual consent, parties competent to contract; free consent, lawful object, consideration etc. apply to contract of Sale of Goods Act also. This lesson is to be taught after the students have been made familiar with the general principles of contract in which the emphasis is on understanding and appreciating the basic essentials of a valid contract and on the existence of contractual relationship in various instances. In today's era, the need for awareness of buyers and sellers rights is of utmost importance.

The law relating to sale of goods is contained in the Sale of Goods Act, 1930. It has to be read as part of the Indian Contract Act, 1872 [Sections 2(5) and (3)].

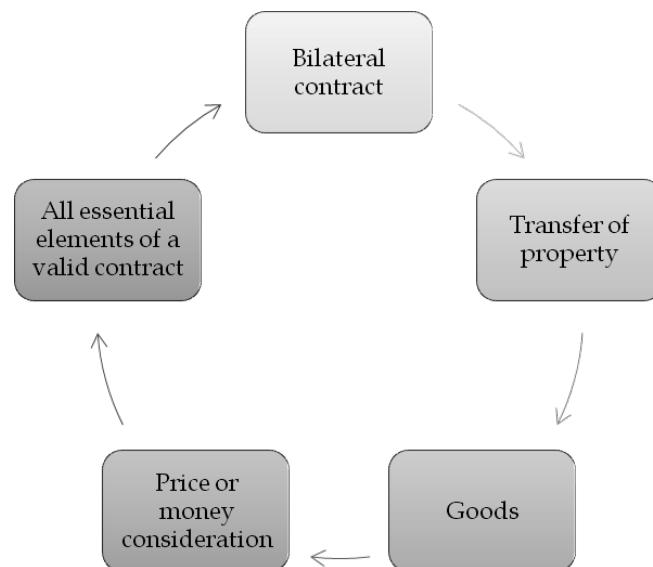
## CONTRACT OF SALE OF GOODS

According to Section 4, a contract of sale of goods is a contract whereby the seller:

- (i) transfers or agrees to transfer the property in goods,
- (ii) to the buyer,
- (iii) for a money consideration called the price.

It shows that the expression "contract of sale" includes both a sale where the seller transfers the ownership of the goods to the buyer, and an agreement to sell where the ownership of goods is to be transferred at a future time or subject to some conditions to be fulfilled later on.

***The following are thus the essentials of a contract of sale of goods:***



- (i) **Bilateral contract:** It is a bilateral contract because the property in goods has to pass from one party to another. A person cannot buy the goods himself.
- (ii) **Transfer of property:** The object of a contract of sale must be the transfer of property (meaning ownership) in goods from one person to another.
- (iii) **Goods:** The subject matter must be some goods.
- (iv) **Price or money consideration:** The goods must be sold for some price, where the goods are exchanged for goods it is barter, not sale.
- (v) **All essential elements of a valid contract must be present in a contract of sale.**

## DISTINCTION BETWEEN SALE AND AGREEMENT TO SELL

The following points will bring out the distinction between sale and an agreement to sell:

- (a) In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfilment of some conditions subject to which the property in the goods is to be transferred.
- (b) An agreement to sell is an executory contract, a sale is an executed contract.
- (c) An agreement to sell is a contract pure and simple, but a sale is contract plus conveyance.
- (d) If there is an agreement to sell and the goods are destroyed by accident, the loss falls on the seller. In a sale, the loss falls on the buyer, even though the goods are with the seller.
- (e) If there is an agreement to sell and the seller commits a breach, the buyer has only a personal remedy against the seller, namely, a claim for damages. But if there has been a sale, and the seller commits a breach by refusing to deliver the goods, the buyer has not only a personal remedy against him but also the other remedies which an owner has in respect of goods themselves such as a suit for conversion or detinue, etc.

## SALE AND BAILMENT

A “bailment” is a transaction under which goods are delivered by one person (the bailor) to another (the bailee) for some purpose, upon a contract that they be returned or disposed of as directed after the purpose is accomplished (Section 148 of the Indian Contract Act, 1872).

The property in the goods is not intended to and does not pass on delivery though it may sometimes be the intention of the parties that it should pass in due course. But where goods are delivered to another on terms which indicate that the property is to pass at once the contract must be one of sale and not bailment.

## SALE AND CONTRACT FOR WORK AND LABOUR

The distinction between a “sale” and a “contract for work and labour” becomes important when question of passing of property arises for consideration.

“Sale”, is a contract by which property in goods passes from the seller to the buyer for a price.

However, these two are difficult to distinguish. The test generally applied is that if as a result of the contract, property in an article is transferred to one who had no property therein previously for a money consideration, it is a sale, where it is otherwise it is a contract for work and labour.

## SALE AND HIRE PURCHASE AGREEMENT

A “hire purchase agreement” is basically a contract of hire, but in addition, it gives the hirer an option to purchase the goods at the end of the hiring period. Consequently, until the final payment, the hirer is merely a bailee of goods and ownership remains vested in the bailor. Under such a contract, the owner of goods delivers the goods to person who agrees to pay certain stipulated periodical payments as hire charges. Though the possession is with the hirer, the ownership of the goods remains with the original owner.

The essence of hire purchase agreement is that there is no agreement to buy, but only an option is given to the hirer to buy by paying all the instalments or put an end to the hiring and return the goods to the owner, at any time before the exercise of the option.

Since the hirer does not become owner of the goods until he has exercised his option to buy, he cannot pass any title even to an innocent and *bona fide* purchaser. The transaction of hire-purchase protects the owner of the goods against the insolvency of the buyer, for if the buyer becomes insolvent or fails to pay the instalments, he can take back the goods as owner. And if the hirer declines to take delivery of the goods, the remedy of the owner will be damages for non-hiring and not for rent for the period agreed.

It is important to note the difference between a hire purchase agreement and mere payment of the price by instalments because, the latter is a sale, only the payment of price is to be made by instalments.

The distinction between the two is very important because, in a hire-purchase agreement the risk of loss or deterioration of the goods hired lies with the owner and the hirer will be absolved of any responsibility therefor, if he has taken reasonable care to protect the same as a bailee. But it is otherwise in the case of a sale where the price is to be paid in instalments.

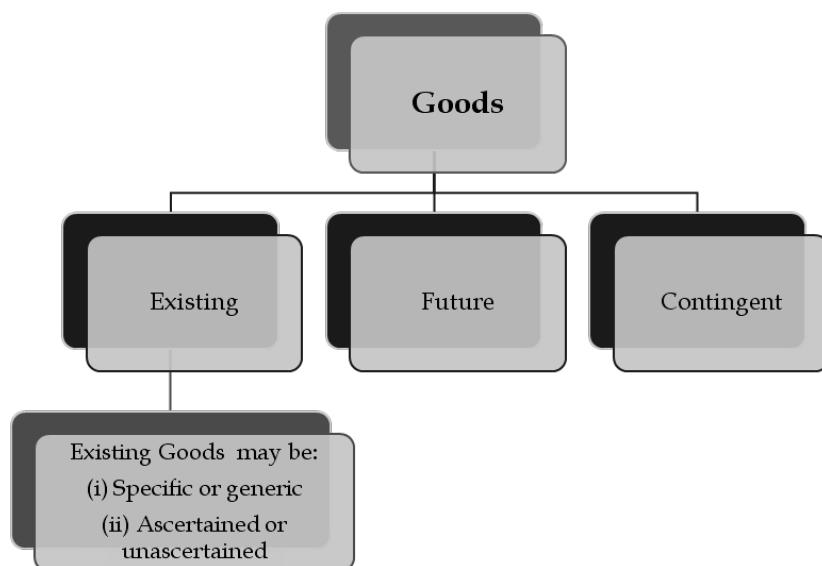
## SUBJECT MATTER OF CONTRACT OF SALE OF GOODS

### Goods

The subject matter of the contract of sale is essentially goods. According to Section 2(7) of the Sale of Goods Act, "goods" means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale.

Actionable claims and money are not goods and cannot be brought and sold under this Act. Money means current money, i.e., the recognised currency in circulation in the country, but not old and rare coins which may be treated as goods. An actionable claim is what a person cannot make a present use of or enjoy, but what can be recovered by him by means of a suit or an action. Thus, a debt due to a man from another is an actionable claim and cannot be sold as goods, although it can be assigned. Under the provisions of the Transfer of Property Act, 1882, goodwill, trade marks, copyrights, patents are all goods, so is a ship. As regards water, gas, electricity, it is doubtful whether they are goods (*Rash Behari v. Emperor*, (1936) 41 C.W.N. 225; *M.B. Electric Supply Co. Ltd. vs. State of Rajasthan*, AIR (1973) Raj. 132).

Goods may be (a) existing, (b) future, or (c) contingent. The existing goods may be (i) specific or generic, (ii) ascertained or unascertained.



### Existing Goods

Existing goods are goods which are either owned or possessed by the seller at the time of the contract. Sale of goods possessed but not owned by the seller would be by an agent or pledgee.

Existing goods are specific goods which are identified and agreed upon at the time of the contract of sale. Ascertained goods are either specific goods at the time of the contract or are ascertained or identified to the contract later on i.e. made specific.

Generic or unascertained goods are goods which are not specifically identified but are indicated by description. If a merchant agrees to supply a radio set from his stock of radio sets, it is a contract of sale of unascertained goods because it is not known which set will be delivered. As soon as a particular set is separated or identified for delivery and the buyer has notice of it, the goods are ascertained and become specific goods.

### Future Goods

Future goods are goods to be manufactured or produced or acquired by the seller after the making of the contract of sale. A agrees to sell all the mangoes which will be produced in his garden next season. This is an agreement for the sale of future goods. [Section 2(6)]

### Contingent Goods

Where there is a contract for the sale of goods, the acquisition of which by the seller depends upon a contingency which may or may not happen—such goods are known as contingent goods. Contingent goods fall in the class of future goods. A agrees to sell a certain TV set provided he is able to get it from its present owner. This is an agreement to sell contingent goods. In such a case, if the contingency does not happen for no fault of the seller, he will not be liable for damages.

Actual sale can take place only of specific goods and property in goods passes from the seller to buyer at the time of the contract, provided the goods are in a deliverable state and the contract is unconditional.

There can be an agreement to sell only in respect of future or contingent goods.

### Effect of Perishing of Goods

In a contract of sale of goods, the goods may perish before sale is complete. Such a stage may arise in the following cases:

#### *(i) Goods perishing before making a contract*

Where in a contract of sale of specific goods, the goods without the knowledge of the seller have, at the time of making the contract perished or become so damaged as no longer to answer to their description in the contract, the contract is void. This is based on the rule that mutual mistake of fact essential to the contract renders the contract void. (Section 7)

If the seller was aware of the destruction and still entered into the contract, he is estopped from disputing the contract. Moreover, perishing of goods not only includes loss by theft but also where the goods have lost their commercial value.

#### *(ii) Goods perishing after agreement to sell*

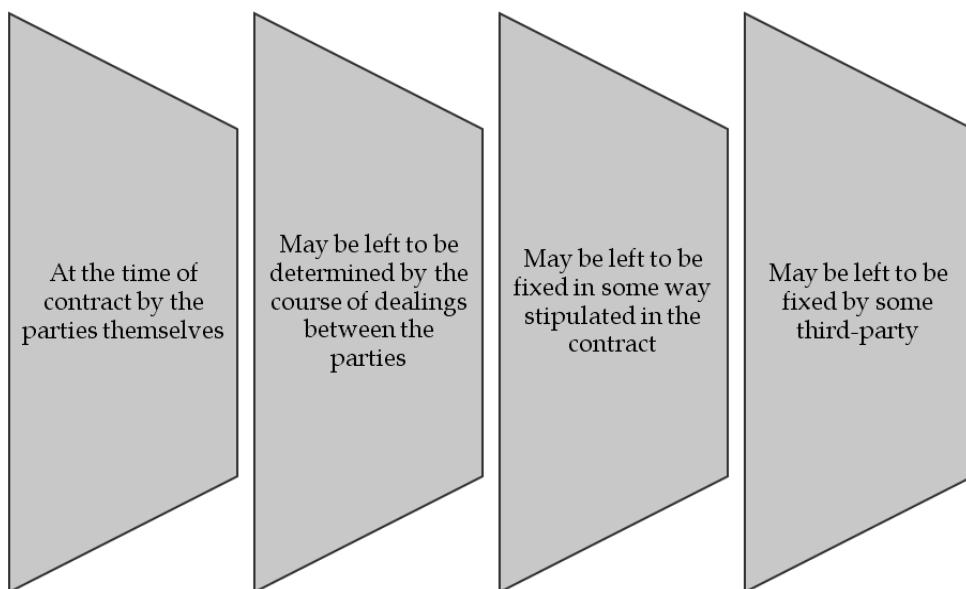
Where there is an agreement to sell specific goods, and subsequently the goods without any fault of any party perish or are so damaged as no longer to answer to their description in the agreement before the risk passes to the buyer, the agreement is thereby avoided. The provision applies only to sale of specific goods. If the sale is of unascertained goods, the perishing of the whole quantity of such goods in the possession of the seller will not relieve him of his obligation to deliver. (Section 8)

### Price

No sale can take place without a price. Thus, if there is no valuable consideration to support a voluntary surrender of goods by the real owner to another person, the transaction is a gift, and is not governed by the Sale of Goods Act. Therefore, price, which is money consideration for the sale of goods, constitutes the essence for a contract of sale. It may be money actually paid or promised to be paid. If a consideration other than money is to be given, it is not a sale.

## Modes of Fixing Price (Sections 9 and 10)

The price may be fixed:



Where the contract states that the price is to be fixed by a third-party and such third-party fails to do so, the contract is void. But if the buyer has already taken the benefit of the goods, he must pay a reasonable price for them. If the third-party's failure to fix the price is due to the fault of the seller or buyer, then that party is liable for an action for damages.

Where nothing is said by the parties regarding price, the buyer must pay a reasonable price. What is a reasonable price is a question of fact dependent upon the circumstances of each particular case. Generally, the market price would be a reasonable price.

## Conditions and Warranties (Sections 12-17)

The parties are at liberty to enter into a contract with any terms they please. As a rule, before a contract of sale is concluded, certain statements are made by the parties to each other. The statement may amount to a stipulation, forming part of the contract or a mere expression of opinion which is not part of the contract. If it is a statement by the seller on the reliance of which the buyer makes the contract, it will amount to a stipulation. If it is a mere commendation by the seller of his goods it does not amount to a stipulation and does not give the right of action.

The stipulation may either be a condition or a warranty. Section 12 draws a clear distinction between a condition and a warranty. Whether a stipulation is a condition or only a warranty is a matter of substance rather than the form of the words used. A stipulation may be a condition though called a warranty and vice versa.

### Conditions

If the stipulation forms the very basis of the contract or is essential to the main purpose of the contract, it is a condition. The breach of the condition gives the aggrieved party a right to treat the contract as repudiated. Thus, if the seller fails to fulfil a condition, the buyer may treat the contract as repudiated, refuse the goods and, if he has already paid for them, recover the price. He can also claim damages for the breach of contract.

### Warranties

If the stipulation is collateral to the main purpose of the contract, i.e., is a subsidiary promise, it is a warranty. The effect of a breach of a warranty is that the aggrieved party cannot repudiate the contract but can only claim damages. Thus, if the seller does not fulfil a warranty, the buyer must accept the goods and claim damages for breach of warranty.

Section 11 states that the stipulation as to time of payment are not to be deemed conditions (and hence not to be of the essence of a contract of sale) unless such an intention appears from the contract. Whether any other stipulation as to time (e.g., time of delivery) is of the essence of the contract or not depends on the terms of the contract.

### When condition sinks to the level of warranty

In some cases a condition sinks or descends to the level of a warranty. The first two cases depend upon the will of the buyer, but the third is compulsory and acts as estoppel against him.

- (a) A condition will become a warranty where the buyer waives the condition; or
- (b) A condition will sink to the level of a warranty where the buyer treats the breach of condition as a breach of warranty; or
- (c) Where the contract is indivisible and the buyer has accepted the goods or part thereof, the breach of condition can only be treated as breach of warranty. The buyer can only claim damages and cannot reject the goods or treat the contract as repudiated.

Sometimes the seller may be excused by law from fulfilling any condition or warranty and the buyer will not then have a remedy in damages.

### Implied Warranties/Conditions

Even where no definite representations have been made, the law implies certain representations as having been made which may be warranties or conditions. An express warranty or condition does not negative an implied warranty or condition unless inconsistent therewith.

*There are two implied warranties:*

#### Implied Warranties [Section 14(b), 14(c) and 16(3)]

- (a) Implied warranty of quiet possession: If the circumstances of the contract are such as there is an implied warranty that the buyer shall have and enjoy quiet possession of the goods.
- (b) Implied warranty against encumbrances: There is a further warranty that the goods are not subject to any right in favour of a third-party, or the buyer's possession shall not be disturbed by reason of the existence of encumbrances. This means that if the buyer is required to, and does discharge the amount of the encumbrance, there is breach of warranty, and he is entitled to claim damages from the seller.

*Implied Conditions* [Sections 14(a), 15(1), (2), 16(1) and Proviso 16(2), and Proviso 16(3) and 12(b) and 12(c)].

Different implied conditions apply under different types of contracts of sale of goods, such as sale by description, or sale by sample, or sale by description as well as sample. The condition, as to title to goods applies to all types of contracts, subject to that there is apparently no other intention.

#### Implied Conditions as to title

There is an implied condition that the seller, in an actual sale, has the right to sell the goods, and, in an agreement to sell, he will have a right to sell the goods at the time when property is to pass. As a result, if the title of the seller turns out to be defective, the buyer is entitled to reject the goods and can recover the full price paid by him.

In *Rowland v. Dival* (1923) 2 K.B. 500, 'A' had bought a second hand motor car from 'B' and paid for it. After he had used it for six months, he was deprived of it because the seller had no title to it. It was held that 'B' had broken the condition as to title and 'A' was therefore, entitled to recover the purchase money from 'B'

#### Implied conditions under a sale by description

In a sale by description there are the following implied conditions:

**(a) Goods must correspond with description:** It is provided under Section 15 of the Act that when there is a sale of goods by description, there is an implied condition that the goods shall correspond with description.

In a sale by description, the buyer relies for his information on the description of the goods given by the seller, e.g. in the contract or in the preliminary negotiations.

Where 'A' buys goods which he has not seen, it must be sale by description, e.g., where he buys a 'new Fiat car' from 'B' and the car is not new, he can reject the car.

Even if the buyer has seen the goods, the goods must be in accordance with the description (*Beale v. Taylor* (1967) All E.R. 253).

**(b) Goods must also be of merchantable quality:** If they are bought by description from dealer of goods of that description. [Section 16(2)]

*Merchantable quality* means that the goods must be such as would be acceptable to a reasonable person, having regard to prevailing conditions. They are not merchantable if they have defects which make them unfit for ordinary use, or are such that a reasonable person knowing of their condition would not buy them. 'P' bought black yarn from 'D' and, when delivered, found it damaged by the white ants. The condition of merchantability was broken.

But, if the buyer has examined the goods, there is no implied condition as regards defects which such examination ought to have revealed. If, however, examination by the buyer does not reveal the defect and he approves and accepts the goods, but when put to work, the goods are found to be defective, there is a breach of condition of merchantable quality.

The buyer is given a right to examine the goods before accepting them. But a mere opportunity without an actual examination, however, cursory, would not suffice to deprive him of this right.

**(c) Condition as to wholesomeness:** The provisions, (i.e., eatables) supplied must not only answer the description, but they must also be merchantable and wholesome or sound. 'F' bought milk from 'A' and the milk contained typhoid germs. 'F's wife became infected and died. 'A' was liable for damages. Again, 'C' bought a bun at 'M's bakery, and broke one of his teeth by biting on a stone present in the bun. 'M' was held liable.

**(d) Condition as to quality or fitness for a particular purpose:** Ordinarily, in a contract of sale, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied.

But there is an implied condition that the goods are reasonably fit for the purpose for which they are required if:

- (i) the buyer expressly or by implication makes known to the seller the particular purpose for which the goods are required, so as to show that he relies on the seller's skill and judgement, and
- (ii) the goods are of a description which it is in the course of the seller's business to supply (whether he is the manufacturer or producer or not). There is no such condition if the goods are bought under a patent or trade name.

In *Priest v. Last* (1903) 2 K.B. 148, a hot water bottle was bought by the plaintiff, a draper, who could not be expected to have special skill knowledge with regard to hot water bottles, from a chemist, who sold such articles stating that the bottle will not stand boiling water but was intended to hold hot water. While being used by the plaintiff's wife, the bottle bursted and injured her. *Held*, the seller was responsible for damages as the bottle was not fit for use as a hot water bottle.

In *Grant v. Australian Knitting Mills* (1936) 70 MLJ 513, 'G' a doctor purchased woollen underpants from 'M' a retailer whose business was to sell goods of that description. After wearing the underpants, 'G' developed some skin diseases. *Held*, the goods were not fit for their only use and 'G' was entitled to avoid the contract and claim damages.

### Implied conditions under a sale by sample (Section 17)

In a contract of sale by sample:

- (a) there is an implied condition that the bulk shall correspond with the sample in quality;
- (b) there is another implied condition that the buyer shall have a reasonable opportunity of comparing the bulk with the sample;
- (c) it is further an implied condition of merchantability, as regards latent or hidden defects in the goods which would not be apparent on reasonable examination of the sample. "Worsted coating" quality equal to sample was sold to tailors, the cloth was found to have a defect in the fixture rendering the same unfit for stitching into coats. The seller was held liable even though the same defect existed in the sample, which was examined.

### Implied conditions in sale by sample as well as by description

In a sale by sample as well as by description, the goods supplied must correspond both with the samples as well as with the description. Thus, in *Nichol vs. Godts* (1854) 158 E.R. 426, there was a sale of "foreign refined rape-oil having warranty only equal to sample". The oil tendered was the same as the sample, but it was not "foreign refined rape-oil" having a mixture of it and other oil. It was held that the seller was liable, and the buyer could refuse to accept.

### IMPLIED WARRANTIES

Implied warranties are those which the law presumes to have been incorporated in the contract of sale inspite of the fact that the parties have not expressly included them in a contract of sale. Subject to the contract to the contrary, following are the implied warranties in a contract of sale:

- (i) Warranty as to quiet possession: Section 14(b) of the Sale of Goods Act provides that there is an implied warranty that the buyer shall have and enjoy quiet possession of goods. If the buyer's possession is disturbed by anyone having superior title than that of the seller, the buyer is entitled to hold the seller liable for breach of warranty.
- (ii) Warranty as to freedom from encumbrances: Section 14(c) states that in a contract of sale, there is an implied warranty that the goods shall be free from any charge or encumbrance in favour of any third party not declared or known to the buyer before or at the time when the contract is made. But if the buyer is aware of any encumbrance on the goods at the time of entering into the contract, he will not be entitled to any compensation from the seller for discharging the encumbrance.
- (iii) Warranty to disclose dangerous nature of goods: If the goods are inherently dangerous or likely to be dangerous and the buyer is ignorant of the danger, the seller must warn the buyer of the probable danger.
- (iv) Warranties implied by the custom or usage of trade: Section 16(3) provides that an implied warranty or condition as to quality or fitness for a particular purpose may be annexed by the usage of trade.

### Doctrine of Caveat Emptor

This principle states that it is for the buyer to satisfy himself that the goods which he is purchasing are of the quality which he requires. If he buys goods for a particular purpose, he must satisfy himself that they are fit for that purpose. The doctrine of *caveat emptor* is embodied in Section 16 of the Act which states that "subject to the provisions of this Act and of any other law for the time being in force, there is no implied warranty or condition as to the quality or fitness for any particular purpose of goods supplied under a contract of sale". In simple words, it is not the seller's duty to give to the buyer the goods which are fit for a suitable purpose of the buyer. If he makes a wrong selection, he cannot blame the seller if the goods turn out to be defective or do not serve his purpose. The principle was applied in the case of *Ward vs. Hobbs*, (1878) 4 A.C. 13, where certain pigs were sold by auction and no warranty was given by seller in

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The term "*caveat emptor*" is a Latin word which means "let the buyer beware".

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respect of any fault or error of description. The buyer paid the price for healthy pigs. But they were ill and all but one died of typhoid fever. They also infected some of the buyer's own pigs. It was held that there was no implied condition or warranty that the pigs were of good health. It was the buyer's duty to satisfy himself regarding the health of the pigs.

**Exceptions: Section 16 lays down the following exceptions to the doctrine of *Caveat Emptor*:**

- (1) Where the seller makes a false representation and the buyer relies on it.
- (2) When the seller actively conceals a defect in the goods which is not visible on a reasonable examination of the same.
- (3) When the buyer, relying upon the skill and judgement of the seller, has expressly or impliedly communicated to him the purpose for which the goods are required.
- (4) Where goods are bought by description from a seller who deals in goods of that description.

**Passing of Property or Transfer of Ownership (Sections 18-20)**

The sole purpose of a sale is the transfer of ownership of goods from the seller to the buyer. It is important to know the precise moment of time at which the property in the goods passes from the seller to the buyer for the following reasons:

- (a) The general rule is that risk follows the ownership, whether the delivery has been made or not. If the goods are lost or damaged by accident or otherwise, then, subject to certain exceptions, the loss falls on the owner of the goods at the time they are lost or damaged.
- (b) When there is a danger of the goods being damaged by the action of third parties, it is generally the owner who can take action.
- (c) The rights of third parties may depend upon the passing of the property if the buyer resells the goods to a third-party, the third-party will only obtain a good title if the property in the goods has passed to the buyer before or at the time of the resale. Similarly, if the seller, in breach of his contract with the buyer, attempts to sell the goods to a third party in the goods, has not passed to the buyer, e.g., where there is only an agreement to sell.
- (d) In case of insolvency of either the seller or the buyer, it is necessary to know whether the goods can be taken over by the official assignee or the official receiver. It will depend upon whether the property in the goods was with the party adjudged insolvent.

Thus in this context, ownership and possession are two distinct concepts and these two can at times remain separately with two different persons.

**Passing of property in specific goods**

In a sale of specific or ascertained goods, the property in them passes to the buyer as and when the parties intended to pass. The intention must be gathered from the terms of the contract, the conduct of the parties and the circumstances of the case.

Unless a contrary intention appears, the following rules are applicable for ascertaining the intention of the parties:

- (a) Where there is an unconditional contract for the sale of specific goods in a deliverable state, the property in the goods passes to the buyer when the contract is made. Deliverable state means such a state that the buyer would be bound to take delivery of the goods. The fact that the time of delivery or the time of payment is postponed does not prevent the property from passing at once. (Section 20)
- (b) Where there is a contract for the sale of specific goods not in a deliverable state, i.e., the seller has to do something to the goods to put them in a deliverable state, the property does not pass until that thing is done and the buyer has notice of it. (Section 21)

A certain quantity of oil was brought. The oil was to be filled into casks by the seller and then taken away by the buyer. Some casks were filled in the presence of buyer but, before the remainder could be filled, a fire

broke out and the entire quantity of oil was destroyed. Held, the buyer must bear the loss of the oil which was put into the casks (i.e., put in deliverable state) and the seller must bear the loss of the remainder (Rugg vs. Minett (1809) 11 East 210).

- (c) Where there is a sale of specific goods in a deliverable state, but the seller is bound to weigh, measure, test or do something with reference to the goods for the purpose of ascertaining the price, the property to the goods for the purpose of ascertaining the price, does not pass until such act or thing is done and the buyer has notice of it. (Section 22)
- (d) When goods are delivered to the buyer "on approval" or "on sale of return" or other similar terms the property therein passes to the buyer:
  - (i) when he signifies his approval or acceptance to the seller, or does any other act adopting the transaction;
  - (ii) if he does not signify his approval or acceptance but retains the goods without giving notice of rejection, in such a case—(a) if a time has been fixed for the return of the goods, on the expiration of such time; and (b) if no time has been fixed, on the expiration of a reasonable time.

### Ownership in unascertained goods

The property in unascertained or future goods does not pass until the goods are ascertained.

Unascertained goods are goods defined by description only, for example, 100 quintals of wheat; and not goods identified and agreed upon when the contract is made.

Unless a different intention appears, the following rules are applicable for ascertaining the intention of the parties in regard to passing of property in respect of such goods:

- (a) The property in unascertained or future goods sold by description passes to the buyer when goods of that description and in a deliverable state are unconditionally appropriated to the contract, either by the seller with the assent of the buyer or by the buyer with the assent of the seller. Such assent may be expressed or implied and may be given either before or after the appropriation is made. (Section 23)
- (b) If there is a sale of a quantity of goods out of a large quantity, for example, 50 quintals of rice out of a heap in B's godown, the property will pass on the appropriation of the specified quantity by one party with the assent of the other.
- (c) Delivery by the seller of the goods to a carrier or other buyer for the purpose of transmission to the buyer in pursuance of the contract is an appropriation sufficient to pass the property in the goods.
- (d) The property in goods, whether specific or unascertained, does not pass if the seller reserves the right of disposal of the goods. Apart from an express reservation of the right of disposal, the seller is deemed to reserve the right of disposal in the following two cases:
  - (i) where goods are shipped or delivered to a railway administration for carriage by railway and by the bill of lading or railway receipt, the goods are deliverable to the order of the seller or his agent.
  - (ii) when the seller sends the bill of exchange for the price of the goods to the buyer for this acceptance, together with the bill of lading, the property in the goods does not pass to the buyer unless he accepts the bill of exchange.

### Passing of Risk (Section 26)

The general rule is that goods remain at the seller's risk until the ownership is transferred to the buyer. After the ownership has passed to the buyer, the goods are at the buyer's risk whether the delivery has been made or not.

For example, 'A' buys goods of 'B' and property has passed from 'B' to 'A'; but the goods remain in 'B's warehouse and the price is unpaid. Before delivery, 'B's warehouse is burnt down for no fault of 'B' and the goods are destroyed. 'A' must pay 'B' the price of the goods, as he was the owner. The rule is *res perit domino*- the loss falls on the owner.

But the parties may agree that risk will pass at the time different from the time when ownership passed. For example, the seller may agree to be responsible for the goods even after the ownership is passed to the buyer or *vice versa*.

In *Consolidated Coffee Ltd. v. Coffee Board*, (1980 3 SCC 358), one of the terms adopted by coffee board for auction of coffee was the property in the coffee knocked down to a bidder would not pass until the payment of price and in the meantime the goods would remain with the seller but at the risk of the buyer, In such cases, risk and property passes on at different stages.

In *Multanmal Champalal v. Shah & Co, AIR (1970) Mysore 106*, goods were despatched by the seller from Bombay to Bellary through a public carrier. According to the terms of the contract, the goods were to remain the property of the seller till the price was paid though the risk was to pass to the buyer when they were delivered to public carrier for despatch. When the goods were subsequently lost before the payment of the price (and the consequent to the passing of the property to the buyer), the Court held that the loss was to be borne by the buyer.

It was further held in the same case that the buyer was at fault in delaying delivery unreasonably and therefore on that ground also he was liable for the loss, because such loss would not have arisen but for such delay.

Thus, where delivery has been delayed through the fault of either the buyer or the seller, in such a case, the goods are at the risk of the party at fault as regards any loss which might not have occurred but for such fault.

### Transfer of Title by Person not the Owner (Section 27-30)

The general rule is that only the owner of goods can sell the goods. Conversely, the sale of an article by a person who is not or who has not the authority of the owner, gives no title to the buyer. The rule is expressed by the maxim; "*Nemo Dat Quod Non Habet*" i.e. no one can pass a better title than he himself has. As applied to the sale of goods, the rule means that a seller of goods cannot give a better title to the buyer than he himself possess. Thus, even a *bona fide* buyer who buys stolen goods from a thief or from a transfree from such a thief can get no valid title to them, since the thief has no title, nor could he give one to any transferee.

#### Example:

- (1) A, the hirer of goods under a hire purchase agreement, sells them to B, though a bona fide purchaser, does not acquire the property in the goods. At most he can acquire such an interest as the hirer had.
- (2) A finds a ring of B and sells it to a third person who purchases it for value and in good faith. The true owner, i.e. B can recover from that person, for A having no title to the ring could pass none the better.

### Exception to the General Rule

The Act while recognizing the general rule that no one can give a better title than he himself has, laid down important exceptions to it. Under the exceptions the buyer gets a better title to the goods than the seller himself. These exceptions are given below:

- (a) Sale by a mercantile agent: A buyer will get a good title if he buys in good faith from a mercantile agent who is in possession either of the goods or documents of title to the goods with the consent of the owner, and who sells the goods in the ordinary course of his business.
- (b) Sale by a co-owner: A buyer who buys in good faith from one of the several joint owners who is in sole possession of the goods with the permission of his co-owners will get good title to the goods.
- (c) Sale by a person in possession under a voidable contract: A buyer buys in good faith from a person in possession of goods under a contract which is voidable, but has not been rescinded at the time of the sale.
- (d) Sale by seller in possession after sale: Where a seller, after having sold the goods, continues or is in possession of the goods or of the documents of title to the goods and again sells them by himself or through his mercantile agent to a person who buys in good faith and without notice of the previous sale, such a buyer gets a good title to the goods.

- (e) Sale by buyer in possession: If a person has brought or agreed to buy goods obtains, with the seller's consent, possession of the goods or of the documents of title to them, any sale by him or by his mercantile agent to a buyer who takes in good faith without notice of any lien or other claim of the original seller against the goods, will give a good title to the buyer. In any of the above cases, if the transfer is by way of pledge or pawn only, it will be valid as a pledge or pawn.
- (f) Estoppel: If the true owner stands by and allows an innocent buyer to pay over money to a third-party, who professes to have the right to sell an article, the true owner will be estopped from denying the third-party's right to sell.
- (g) Sale by an unpaid seller: Where an unpaid seller has exercised his right of lien or stoppage in transit and is in possession of the goods, he may resell them and the second buyer will get absolute right to the goods.
- (h) Sale by person under other laws: A pawnee, on default of the pawnee to repay, has a right to sell the goods, pawned and the buyer gets a good title to the goods. The finder of lost goods can also sell under certain circumstances. The Official Assignee or Official Receiver, Liquidator, Officers of Court selling under a decree, Executors, and Administrators, all these persons are not owners, but they can convey better title than they have.

### Performance of the Contract of Sale

It is the duty of the seller and buyer that the contract is performed. The duty of the seller is to deliver the goods and that of the buyer is to accept the goods and pay for them in accordance with the contract of sale.

Unless otherwise agreed, payment of the price and the delivery of the goods are concurrent conditions, i.e., they both take place at the same time as in a cash sale over a shop counter.

### Delivery (Sections 33-39)

Delivery is the voluntary transfer of possession from one person to another. Delivery may be actual, constructive or symbolic. *Actual or physical delivery* takes place where the goods are handed over by the seller to the buyer or his agent authorised to take possession of the goods. *Constructive delivery* takes place when the person in possession of the goods acknowledges that he holds the goods on behalf of and at the disposal of the buyer. For example, where the seller, after having sold the goods, may hold them as bailee for the buyer, there is constructive delivery. *Symbolic delivery* is made by indicating or giving a symbol. Here the goods themselves are not delivered, but the "means of obtaining possession" of goods is delivered, e.g., by delivering the key of the warehouse where the goods are stored, bill of lading which will entitle the holder to receive the goods on the arrival of the ship.

### Rules as to delivery

The following rules apply regarding delivery of goods:

- (a) Delivery should have the effect of putting the buyer in possession.
- (b) The seller must deliver the goods according to the contract.
- (c) The seller is to deliver the goods when the buyer applies for delivery; it is the duty of the buyer to claim delivery.
- (d) Where the goods at the time of the sale are in the possession of a third person, there will be delivery only when that person acknowledges to the buyer that he holds the goods on his behalf.
- (e) The seller should tender delivery so that the buyer can take the goods. It is no duty of the seller to send or carry the goods to the buyer unless the contract so provides. But the goods must be in a deliverable state at the time of delivery or tender of delivery. If by the contract the seller is bound to send the goods to the buyer, but no time is fixed, the seller is bound to send them within a reasonable time.
- (f) The place of delivery is usually stated in the contract. Where it is so stated, the goods must be delivered at the specified place during working hours on a working day. Where no place is mentioned, the goods are to be delivered at a place at which they happen to be at the time of the contract of sale and if not then in existence they are to be delivered at the place at which they are manufactured or produced.

- (g) The seller has to bear the cost of delivery unless the contract otherwise provides. While the cost of obtaining delivery is said to be of the buyer, the cost of the putting the goods into deliverable state must be borne by the seller. In other words, in the absence of an agreement to the contrary, the expenses of and incidental to making delivery of the goods must be borne by the seller; the expenses of and incidental to receiving delivery must be borne by the buyer.
- (h) If the goods are to be delivered at a place other than where they are, the risk of deterioration in transit will, unless otherwise agreed, be borne by the buyer.
- (i) Unless otherwise agreed, the buyer is not bound to accept delivery in instalments.

### Acceptance of Goods by the Buyer

Acceptance of the goods by the buyer takes place when the buyer:

- (a) intimates to the seller that he has accepted the goods; or
- (b) retains the goods, after the lapse of a reasonable time without intimating to the seller that he has rejected them; or
- (c) does any act on the goods which is inconsistent with the ownership of the seller, e.g., pledges or resells. If the seller sends the buyer a larger or smaller quantity of goods than ordered, the buyer may:
  - (i) reject the whole; or
  - (ii) accept the whole; or
  - (iii) accept the quantity ordered and reject the rest.

If the seller delivers with the goods ordered, goods of a wrong description, the buyer may accept the goods ordered and reject the rest, or reject the whole.

Where the buyer rightly rejects the goods, he is not bound to return the rejected goods to the seller. It is sufficient if he intimates the seller that he refuses to accept them. In that case, the seller has to remove them.

### Instalment Deliveries

When there is a contract for the sale of goods to be delivered by stated instalments which are to be separately paid for, and either the buyer or the seller commits a breach of contract, it depends on the terms of the contract whether the breach is a repudiation of the whole contract or a severable breach merely giving right to claim for damages.

### Suits for Breach of Contract

Where the property in the goods has passed to the buyer, the seller may sue him for the price.

Where the price is payable on a certain day regardless of delivery, the seller may sue for the price, if it is not paid on that day, although the property in the goods has not passed.

Where the buyer wrongfully neglects or refuses to accept the goods and pay for them, the seller may sue the buyer for damages for non-acceptance.

Where the seller wrongfully neglects or refuses to deliver the goods to the buyer, the buyer may sue him for damages for non-delivery.

Where there is a breach of warranty or where the buyer elects or is compelled to treat the breach of condition as a breach of warranty, the buyer cannot reject the goods. He can set breach of warranty in extinction or diminution of the price payable by him and if loss suffered by him is more than the price he may sue for the damages.

If the buyer has paid the price and the goods are not delivered, the buyer can sue the seller for the recovery of the amount paid. In appropriate cases the buyer can also get an order from the court that the specific goods ought to be delivered.

## Anticipatory Breach

Where either party to a contract of sale repudiates the contract before the date of delivery, the other party may either treat the contract as still subsisting and wait till the date of delivery, or he may treat the contract as rescinded and sue for damages for the breach.

In case the contract is treated as still subsisting it would be for the benefit of both the parties and the party who had originally repudiated will not be deprived of:

- (a) his right of performance on the due date in spite of his prior repudiation; or
- (b) his rights to set up any defence for non-performance which might have actually arisen after the date of the prior repudiation.

## Measure of Damages

The Act does not specifically provide for rules as regards the measure of damages except by stating that nothing in the Act shall affect the right of the seller or the buyer to recover interest or special damages in any case where by law they are entitled to the same. The inference is that the rules laid down in Section 73 of the Indian Contract Act will apply.

## Unpaid Seller (Sections 45-54)

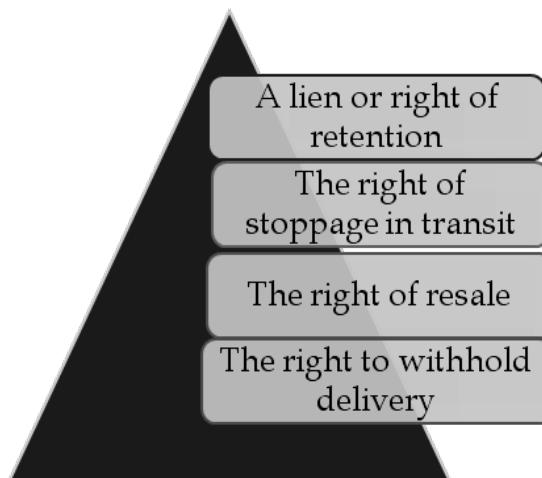
### ***Who is an unpaid seller? (Section 45)***

The seller of goods is deemed to be unpaid seller:

- (a) When the whole of the price has not been paid or tendered; or
- (b) When a conditional payment was made by a bill of exchange or other negotiable instrument, and the instrument has been dishonoured.

## Rights of an Unpaid Seller against the Goods

### ***An unpaid seller's right against the goods are:***



(a) *Right of Lien* (Sections 47-49 and 54) An unpaid seller in possession of goods sold, may exercise his lien on the goods, i.e., keep the goods in his possession and refuse to deliver them to the buyer until the fulfilment or tender of the price in cases where:

- (i) the goods have been sold without stipulation as to credit; or
- (ii) the goods have been sold on credit, but the term of credit has expired; or

(iii) the buyer becomes insolvent.

The lien depends on physical possession. The seller's lien is *possessory lien*, so that it can be exercised only so long as the seller is in possession of the goods. It can only be exercised for the non-payment of the price and not for any other charges.

A lien is lost –

- (i) When the seller delivers the goods to a carrier or other bailee for the purpose of transmission to the buyer, without reserving the right of disposal of the goods;
- (ii) When the buyer or his agent lawfully obtains possession of the goods;
- (iii) By waiver of his lien by the unpaid seller.

(b) *Stoppage in transit* (Sections 50-52) The right of stoppage in transit is a right of stopping the goods while they are in transit, resuming possession of them and retaining possession until payment of the price.

The right to stop goods is available to an unpaid seller

- (i) when the buyer becomes insolvent; and
- (ii) the goods are in transit.

The buyer is insolvent if he has ceased to pay his debts in the ordinary course of business, or cannot pay his debts as they become due. It is not necessary that he has actually been declared insolvent by the court.

The goods are in transit from the time they are delivered to a carrier or other bailee like a wharfinger or warehousekeeper for the purpose of transmission to the buyer and until the buyer takes delivery of them.

The transit comes to an end in the following cases:

- (i) If the buyer obtains delivery before the arrival of the goods at their destination;
- (ii) If, after the arrival of the goods at their destination, the carrier acknowledges to the buyer that he holds the goods on his behalf, even if further destination of the goods is indicated by the buyer;
- (iii) If the carrier wrongfully refuses to deliver the goods to the buyer.

If the goods are rejected by the buyer and the carrier or other bailee holds them, the transit will be deemed to continue even if the seller has refused to receive them back.

The right to stop in transit may be exercised by the unpaid seller either by taking actual possession of the goods or by giving notice of the seller's claim to the carrier or other person having control of the goods. On notice being given to the carrier, he must redeliver the goods to the seller who must pay the expenses of the redelivery.

The seller's right of lien or stoppage in transit is not affected by any sale on the part of the buyer unless the seller has assented to it. A transfer, however, of the bill of lading or other document of seller to a bona fide purchaser for value is valid against the seller's right.

(c) *Right of re-sale* (Section 54): The unpaid seller may re-sell:

- (i) where the goods are perishable;
- (ii) where the right is expressly reserved in the contract;
- (iii) where in exercise of right of lien or stoppage in transit, the seller gives notice to the buyer of his intention to re-sell, and the buyer, does not pay or tender the price within a reasonable time.

If on a re-sale, there is a deficiency between the price due and amount realised, he is entitled to recover it from the buyer. If there is a surplus, he can keep it. He will not have these rights if he has not given any notice and he will have to pay the buyer profit, if any, on the resale.

(d) *Rights to withhold delivery*: If the property in the goods has passed, the unpaid seller has right as described above. If, however, the property has not passed, the unpaid seller has a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit.

### Rights of an unpaid seller against the buyer (Sections 55 and 56)

An unpaid seller may sue the buyer for the price of the goods in case of breach of contract where the property in the goods has passed to the buyer or he has wrongfully refused to pay the price according to the terms of the contract.

The seller may sue the buyer even if the property in the goods has not passed where the price is payable on a certain day.

Under Section 56, the seller may sue the buyer for damages or breach of contract where the buyer wrongfully neglects or refuses to accept and pay for the goods.

Thus an unpaid sellers rights against the buyer personally are:

- (a) a suit for the price.
- (b) a suit for damages.

### Auction Sales (Section 64)

A sale by auction is a public sale where goods are offered to be taken by bidders. It is a proceeding at which people are invited to complete for the purchase of property by successive offer of advancing sums.

Section 64 lays down the rules regulating auction sales. Where goods are put up for sale in lots, each, lot is *prima facie* deemed to be the subject of a separate contract of sale. The sale is complete when the auctioneer announces its completion by the fall of the hammer or in other customary manner. Until such announcement is made, any bidder may retract his bid.

A right to bid may be reserved expressly by or on behalf of the seller. Where such right is expressly so reserved, the seller or any other person on his behalf may bid at the auction. Where the sale is not notified to be subject to a right to bid on behalf of the seller, it shall not be lawful for the seller to bid himself or to employ any person to bid at such sale, or for the auctioneer knowingly to take any bid from the seller or any such person. Any sale in contravention of this rule may be treated as fraudulent by the buyer. The sale may be notified to be subject to a reserved price. Where there is such notification, every bid is a conditional offer subject to its being up to the reserve price. Where an auctioneer inadvertently knocks down to a bidder who has bid less than the reserved price, there is no contract of sale. If the seller makes use of pretended bidding to raise the price, the sale is voidable at the option of the buyer.

### Trading Contracts Involving Rail or Sea Transit

In the case of a contract for the sale of goods which are to be shipped by sea a number of conditions are attached by the parties or by custom and practice of merchants. Some of the important types of such contracts are given below:

(a) F.O.B.(Free on Board): Under an F.O.B. contract, it is the duty of the seller to put the goods on board a ship at his own expenses. The property in goods passes to the buyer only after the goods have been put on board the ship, and they are at buyer's risk as soon as they are put on board the ship, usually named by the buyer. The seller must notify the buyer immediately that the goods have been delivered on board, so that the buyer may insure them. If he fails to do so the goods shall be deemed to be at seller's risk during such sea transit.

(b) F.O.R. (Free on Rail): Similar position prevails in these contracts as in the case of F.O.B. contracts.

(c) C.I.F or C.F.I. (Cost Insurance and Freight): A CIF contract is a contract for the sale of insured goods lost or not lost to be implemented by transfer of proper documents.

In such types of contracts, the seller not only bears all the expenses of putting the goods on board the ship as in an F.O.B. contract, but also to bear the freight and insurance charges. He will arrange for an insurance of the goods for the benefit of the buyer. On the tender of documents, the buyer is required to pay and then take delivery. He has a right to reject the goods if they are not according to the contract.

(d) Ex-Ship: Here the seller is bound to arrange the shipment of the goods to the port of destination, and to such further inland destination as the buyer may stipulate. The buyer is not bound to pay until the goods are ready for unloading from the ship and all freight charges paid. The goods travel at the seller's risk, but he is not bound to insure them.

**LESSON ROUND-UP**

- In a sale, the property in the goods sold passes to the buyer at the time of contract so that he becomes the owner of the goods. In an agreement to sell, the ownership does not pass to the buyer at the time of the contract, but it passes only when it becomes sale on the expiry of certain time or the fulfilment of some conditions subject to which the property in the goods is to be transferred.
- Where goods are delivered to another on terms which indicate that the property is to pass at once the contract must be one of sale and not bailment.
- The subject matter of the contract of sale is essentially goods. According to Section 2(7) of the Sale of Goods Act, "goods" means every kind of movable property other than actionable claims and money and includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. Goods may be (a) existing, (b) future, or (c) contingent. The existing goods may be (i) specific or generic, (ii) ascertained or unascertained.
- The sole purpose of a sale is the transfer of ownership of goods from the seller to the buyer. The general rule is that only the owner of goods can sell the goods. Conversely, the sale of an article by a person who is not or who has not the authority of the owner, gives no title to the buyer.
- It is the duty of the seller and buyer that the contract is performed. The duty of the seller is to deliver the goods and that of the buyer to accept the goods and pay for them in accordance with the contract of sale.
- Unless otherwise agreed, payment of the price and the delivery of the goods and concurrent conditions, i.e., they both take place at the same time as in a cash sale over a shop counter.
- Delivery is the voluntary transfer of possession from one person to another. Delivery may be actual, constructive or symbolic.
- A sale by auction is a public sale where goods are offered to be taken by bidders. It is a proceeding at which people are invited to complete for the purchase of property by successive offer of advancing sums.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define contract of sale of goods and distinguish between sale and agreement to sell and hire purchase agreement.
2. Write short notes on:
  - (i) Existing goods,
  - (ii) Future goods
3. Why it is important to know the time of passing of property?
4. What are the rights of an unpaid seller against the goods and against the buyer?
5. Explain Doctrine of Caveat emptor.

## Lesson 23

# Indian Partnership Act, 1932

### ***Key Concepts One Should Know***

- Partnership
- Firm
- Sharing of Profits
- Partnership Deed
- Partner by Estoppel

### ***Learning Objectives***

#### **To understand:**

- Rights and Liabilities of Partners
- Registration of Firms
- Relation between the Partner
- Admission of New partners
- Dissolution of Firms and Partnership.

### ***Regulatory Framework***

- Indian Partnership Act, 1932

### ***Lesson Outline***

- Nature of Partnership
- Essentials of a Partnership Registration of Partnership
- Classification of Partnership
- Kinds of Partners
- Rights and Duties of Partners
- Relation of Partners to Third Parties
- Dissolution of Partnership
- LESSON ROUND-UP
- TEST YOURSELF

## INTRODUCTION

The Indian Partnership Act, 1932, came into force w.e.f. 1st October, 1932 except section 69, which came into force on the 1st day of October, 1933. It extends to the whole of India except the state of Jammu and Kashmir.

It lays down the important provisions relating to partnership contracts. However, the general principles of the Indian Contracts Act, 1872 which formally contained the provisions of the law of partnership shall apply so far as they are not inconsistent with this Act. (Section 3)

## DEFINITIONS

### Partnership

According to Section 4 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

When analysed, the definition tells us that in order that persons may become partners, it is essential that:

There must be at least two persons

There must be a relationship arising out of an agreement between two or more persons to do a business

The agreement must be to share the profits of a business

The business must be carried on by all or any of them acting for all

All these four elements must be present before a group or an association can be held to be partners. In other words, it can be said that all the aforesaid four elements must co-exist before a partnership can be said to come into existence. If any one of them is not proved to be present, there cannot be a partnership. The first element relates to the voluntary contractual nature of partnership; the second gives the motive which leads to the formation of firms, i.e. the acquisition of gains; the third shows that the persons of the group who conduct the business do so as agents for all the persons in the group, and are therefore liable to account to all the persons in the group (*Maliram Choudhary vs. Jagannath, AIR 1972 Orissa 17*).

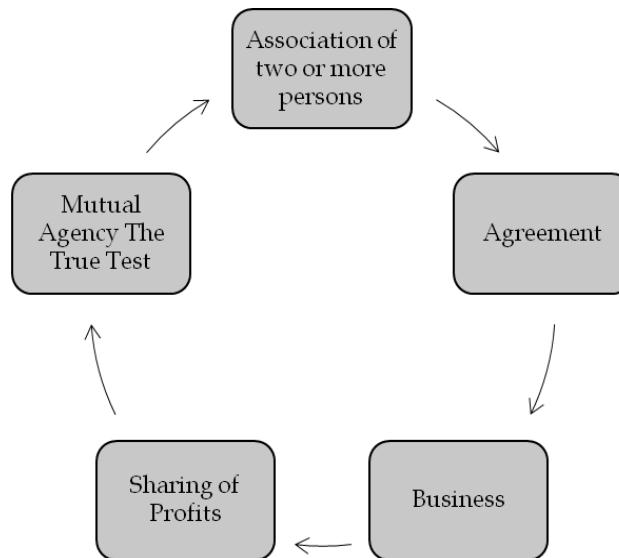
### Partners, Firm and Firm Name

Persons who have entered into partnership with one another are called individually "partners" and collectively "a firm", and the name under which their business is carried on is called the "firm name". (Section 4)

In law, "a firm" is only a convenient phrase for describing the partners, and the firm has no legal existence apart from its partners. It is neither a legal entity, nor is it a person as is a corporation; it is a collective name of the members of a partnership.

As regard the "firm name", partners have a right to carry on business under any name and style which they choose to adopt, provided they do not violate the rules relating to trade name or goodwill. They must not adopt name calculated to mislead the public into confusing them with a firm of repute already in existence with a similar name. They must not use a name implying the sanction of patronage of the Government. A partnership firm cannot use the word "Limited" as a part of its name.

### Essentials of a Partnership and True Test of Partnership



These elements are discussed below in detail:

#### (1) Association of two or more persons

There must be a contract between two or more persons. Therefore unless there are at least two persons there can not be a partnership. Persons must be competent to enter into a contract. They may all be natural or artificial or some natural and other artificial. Thus a corporation or limited partnership may itself be a partner in a general partnership.

#### (2) Agreement

Existence of an agreement is essential of partnership. Section 5 of the Act states that the relation of partnership arises from contract and not from status; and in particular, the members of a Hindu Undivided Family carrying on a family business as such, or a Burmese Buddhist Husband and wife carrying on business as such are not partners in such business.

Such an agreement between the partners may be express or implied. Further, the agreement must be a valid agreement and for a lawful object and purpose and between the persons competent to contract.

#### (3) Business

Partnership implies business and when there is no association to carry on business there is no partnership. The term "business" is, however, used in the widest sense to cover trade, occupation and profession. As per Section 2(b) of the Act the term "business" includes every trade, occupation and profession. In the definition of partnership the word "business" is used in the sense of "carrying on business" which suggests continuity or repetition of acts. But it does not mean that it should be confined to lengthy operations, it may consist of a single adventure of a single undertaking, if there is continued participation of two or more persons for acquisition of gains.

The term must be understood in a particular sense. It refers to any activity which, if successful, would result in profit.

#### **(4) Sharing of Profits**

To constitute a partnership, the parties must have agreed to carry on a business and to share profits in common. "Profits" mean the excess of returns over advances, the excess of what is obtained over the cost of obtaining it. Sharing of profits also involves sharing of losses. But whereas the sharing of profit is an essential element of partnership, the sharing of losses is not. It is open to one or more partners to bear all the losses of the business.

It follows that the sharing of profits is an essential ingredient of partnership and there would be no partnership where only one of the partners is entitled to the whole of the profits of the business. But it is open to the partners to agree to share the profits in any way they like. They may agree to share the profits either in specific proportions or in specific sums.

#### **Sharing of Profits is not Conclusive**

Test although sharing of profits is a *prima facie* evidence of the existence of partnership, this is not the conclusive test of the same. A person may have a share in the partnership profits, but still may not be a partner. For instance, a joint owner of a property sharing its return or members of non-profit or non-trading associations will not be called partners.

#### **Illustrations**

1. A and B buy 100 bales of cotton, which they agree to sell for their joint account, each party sharing profits and bearing losses equally. A and B are partners in respect of such account.
2. A and B buy 100 bales of cotton agreeing to divide these between them. A and B are not partners.
3. "A" a trader, owed money to XY&Z. He agreed to pay XY&Z out of the profits of his business (run under the supervision of X, Y and Z) what he owed to them. It was held that the arrangement does not make X, Y and Z the partners with A in the business.

#### **(5) Mutual Agency The True Test**

Mutual agency is the foundation of partner's liability. Each partner is both an agent and principal for himself and others; that is the significance of the phrase "carried on by all or any of them acting for all". Each partner is an agent binding the other partners who are his principal and each partner is again a principal, who in turn is bound by the acts of the other partners. In other words, there must be facts or circumstances from which it can be inferred that each of the persons alleged to be partners was the agent, real or implied of another. What is essential is that the partner who conducts the business of the firm not only acts for himself but for the other partners also.

The true test, therefore, in determining whether a partnership exists, is to see whether the relation of principal and agent exists between the parties and not merely whether the parties share the profits or the business is carried on for the benefit of all. It is this relation of agency among partners which distinguishes a partnership from a single co-ownership on the one hand and the agreement to share profits on the other. The existence of this relation of agency can be gathered from the real intention of the parties and the circumstances of the case. The question of intention must be decided on the basis of the conduct of parties and of all the surrounding circumstances. The law of partnership is the extension of the law of agency therefore every partner is liable for the act of other partner if within authority upto unlimited extent. The relation of mutual agency is the conclusive test of partnership.

It may be observed that the question whether a person is or is not a partner depends almost in all cases upon whether he has the authority to act for other partners and whether other partners have the authority to act for him. It follows that the agency relationship is the most important test of partnership.

#### **Formation of Partnership**

According to the definition of partnership under the Indian Partnership Act, 1932, there must be an agreement between the partners of a partnership firm.

The partnership agreement must comply with all the essentials of a valid contract. There must be free consent of the parties who must be competent to contract and the object of partnership should not be forbidden by law or

immoral or opposed to public policy. Two exceptions, however, may be noted:

1. A minor may be admitted to the benefits of a partnership with the consent of all other partners.
2. As relations of partners inter se are that of agency, no consideration is required to create the partnership.

## Partnership Deed

The agreement of partnership may be oral but to avoid future disputes it is always advisable to have it in writing. The mutual rights and obligations of partners must be discussed in detail and should be put into writing in the shape of a 'Partnership Deed', before the partnership is actually started. Thus, the written document which contains the mutual rights and obligations of partners is known as partnership deed. (The partnership deed is also called as 'Partnership Agreement', 'Constitution of Partnership', 'Articles of Partnership' etc.). The deed must be properly drafted and stamped according to the provisions of the Indian Stamp Act. Each partner should be given a copy of the deed and if the firm is to be registered, a copy of the deed should be filed with the Registrar of Firms at the time of such legislation. The partnership deed is not a public document and therefore binds only third parties so far as they have notice of it.

### Contents of Partnership Deed

The exact terms of the partnership deed (or agreement) will depend upon the circumstances but generally a partnership deed contains the following covenants:

- (i) The firm name and business to be carried on under that name.
- (ii) Names and addresses of partners.
- (iii) Nature and scope of business and address(s) of business place(s).
- (iv) Commencement and duration of partnership.
- (v) The capital and the contribution made by each partner.
- (vi) Provision for further capital and loans by partners to the firm.
- (vii) Partner's drawings.
- (viii) Interest on capital, loans, drawings and current account.
- (ix) Salaries, commission and remuneration to partners,
- (x) Profit (or loss) sharing ratio of partners.
- (xi) The keeping of proper books of accounts, inspection and audit, Bank Accounts and their operation.
- (xii) The accounting period and the date on which that accounts are to be prepared.
- (xiii) Rights, powers and duties of the partners.
- (xiv) Whether and in what circumstances, notice of retirement or dissolution can be given by a partner.
- (xv) Provision that death or retirement of a partner will not bring about dissolution of partnership,
- (xvi) Valuation of goodwill on retirement, death, dissolution etc.
- (xvii) The method of valuation of assets (and liabilities) on retirement or death of any partner.
- (xviii) Provision for expulsion of a partner.
- (xix) Provision regarding the allocation of business activities to be performed by individual partners.
- (xx) The arbitration clause for the settlement of disputes. The terms contained in the partnership deed may be varied with the consent of all the parties, and such consent may be express or implied by a course of dealing. [Section 11(1)]

## Classification of Partnership

A partnership may either be for a particular adventure or for a fixed period. It may also be a partnership at will. From the duration point of view, a partnership may be classified into the following two categories:

### (i) Particular Partnership (Section 8)

“A person may become a partner with another person in a particular adventure or undertaking”. When two or more persons agree to do business in a particular adventure or undertaking, such a partnership is called “Particular Partnership”. Thus, a particular partnership may even be for a single adventure or undertaking.

### (ii) Partnership at Will (Section 7)

“Where no provision is made by contract between the partners for the duration of their partnership or for the determination of their partnership, the partnership is called Partnership at Will”. A partnership is deemed to be a partnership at will when (i) no fixed period has been agreed upon for the duration of partnership, and (ii) there is no provision made as to the determination of partnership in any other way. The partnership at will has no fixed or definite date of termination and, therefore, death or retirement of a partner does not affect the existence of such partnership.

Section 43(1) provides that “Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm. The firm is dissolved as from the date mentioned in the notice as the date of dissolution or, if no such date is mentioned, as from the date of communication of the notice”. This accounts for the importance of the definition of ‘Partnership at Will’.

## Co-ownership and Partnership

There is a possibility that two co-owners may employ their property in a business and share the profits, and still be not partners. A distinction between the two is in point. Partnership is between two persons Co- ownership is not always the result of an agreement: it may arise by the operation of law or from status, e.g., co-heirs of a property. Partnership must arise from an agreement. A partner is the agent of the other partners, but a co-owner is not the agent of the other co-owner(s). Co-ownership does not necessarily involve community of profits and loss, partnership does. A co-owner can without the consent of the others transfer his rights and interests to strangers, a partner cannot do so without the consent of all the other partners so as to make the transferee a partner in the firm. A co-owner can ask for division of property in specie, but no partner can ask for this. His only right is to have a share of the profits out of the properties.

Partnerships end at death or insolvency; co-ownerships end at death. A co-owner has no lien on the property while a partner has a lien on the firm property.

## Hindu Joint Family Firm and Partnership

A Hindu joint family firm differs from a partnership in the following ways:

A partnership comes into existence by means of a contract between the partners; a Hindu joint family firm arises as a result of status, i.e., by birth in the family. The death of a partner dissolves the partnership, but the death of a co-parcener does not dissolve the family firm. In a joint family firm only the Karta or manager (who is the head of the family) has implied authority to borrow and bind other members; in a partnership each partner is entitled to do so. Every partner is personally liable for the debts of the firm; in a joint family business only the Karta is personally liable. A minor is a member of a joint family firm from the very day of his birth by virtue of his status, but he is not personally liable. A minor cannot be a partner, although he may be admitted to the benefits of partnership. A partner can demand the accounts of the firm, a co-parcener cannot ask for accounts, his only remedy is to ask for partition of the assets of the family firm. No registration of a family firm is necessary, while a partnership firm must be registered before it can maintain suits against outsiders. Each partner has a definite share in the business and this can be changed only by agreement, but the share of a co-parcener is not fixed; it may be enlarged by death or reduced by a birth in the family. There is a definite limit to the number of partners, but there is no such limit in the case of a Hindu joint family firm. A Hindu joint family business is governed by Hindu Law, while Indian Partnership Act, governs partnerships and excludes Hindu joint family firms. (Section 5)

## Company and Partnership

The members constituting a partnership do not form a whole as distinct from the individuals composing it. The firm has no legal entity and has no rights and obligations separate from the partners. In a firm every partner is an agent of the rest of the partners, but a member of a company is neither the agent of the company nor of other members. A company, as soon as it is incorporated, say by registration under the Companies Act, becomes a legal entity distinct from its members constituting it (*Salomon v. Salomon & Co.*, 1897, A.C. 22). It can sue and be sued in its own name like any natural person. In a partnership, there are rights and obligations as against individual partners, but in the case of a company, the rights and obligations are as against the fictitious entity of the whole of the company and not the members composing it. The creditors of the partnership can call upon individual partners to pay the firm's debt, but the members of a company are not personally liable for the company's debts. In other words, a partner's liability is unlimited while the liability of the members of a company is limited to the extent of the amount remaining unpaid on their shares (*Prasad v. Missir*). Partnership firm may dissolve by the death or insolvency of a partner, but a company is not affected by the death or insolvency of a member. A partner cannot transfer his interest so as to substitute the transferee in his place as the partner, without the consent of all the other partners; a member can transfer his share to any one he likes.

### Change in a Firm

The Indian Partnership Act, 1932, contemplates the following changes in a partnership firm:

1. Changes in the constitution of a firm.
2. Changes in the nature of a business or undertakings.
3. Changes in the duration of a firm.

A change in the constitution of a firm takes place when:

- (a) a new partner is introduced as a partner in a firm; (Section 31)
- (b) a partner retires from a firm; (Section 32),
- (c) a partner is expelled from a firm; (Section 33),
- (d) a partner is adjudicated as an insolvent; (Section 34) and
- (e) a partner dies. (Section 35)

A change in the nature of the business can only be brought about by the consent of all the partners. Thus, a partnership formed for a definite purpose, agreed upon at the time of formation of the partnership, cannot depart from the agreed purpose without the consent of all the partners [Section 12(c)]. Section 17(c) provides for a case whether a partnership firm is formed for a particular undertaking or undertakings, it proceeds to carry on other undertaking or undertakings, in that event the mutual rights and duties of the partners in respect of the other adventures or undertakings are the same as those in respect of the original adventures of undertakings.

## Partnership Property

It is open to the partners to agree among themselves as to what is to be treated as the property of the firm, and what is to be separate property of one or more partners, although employed for the purposes of the firm.

In the absence of any such agreement, express or implied, the property of the firm is deemed to include:

- (a) all property, rights and interests which have been brought into the common stock for the purposes of the partnership by individual partners, whether at the commencement of the business or subsequently added thereto;
- (b) those acquired in the course of the business with money belonging to the firm; and
- (c) the goodwill of the business. (Section 14)

The property of the firm belongs to the firm and not to the individual partner or partners. The ownership belongs to the firm, and no partner can deal with specific properties as if the properties are his own, nor does the partner possess any assignable interest in such property (*Narayanappa vs. Bhaskaia Krishnappa*, AIR 1966 SC 1300). What is meant by the share of a partner is his proportion of the partnership assets after they are all realised and converted into money, and all the partnership debts and liabilities have been paid and discharged. If certain partners jointly own immovable property which they use for the purposes of the partnership business, the mere use of such property does not make such property as partnership property. Whether such property is or is not partnership property depends upon the agreement between the partners (*Lachhman Dass vs. Mrs. Gulab Devi*, AIR 1936 ALL. 270).

The ultimate test to determine the property of the firm is the real intention of the partners and the Court can take into consideration the following facts:

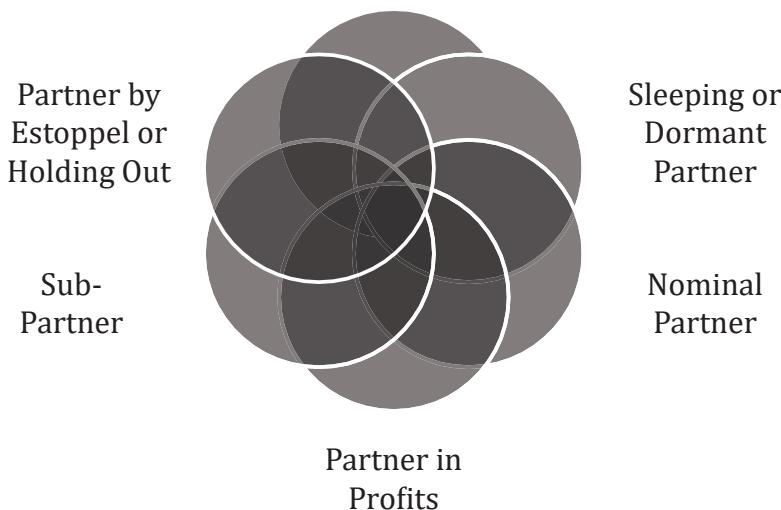
1. The source of the purchase money.
2. The reason due to which the property was purchased or acquired.
3. The object for which the property was purchased or acquired.
4. The mode in which the property was obtained.
5. The mode in which the property was dealt with.
6. The use to which the property was put to.

All such facts are matter of evidence and depend on the facts of each case. These facts indicate the intention of the parties but are not conclusive to make a property as partnership property. These facts can be established by entries in the books of account of the firm and of the partners, correspondence, the deed of partnership, etc.

## Kinds of Partners

The following kinds of partners generally exist in a partnership:

Actual, Active or  
Ostensible Partner



### (i) Actual, Active or Ostensible Partner

These are the ordinary types of partners who invest money into the business of the firm, actively participate in the functioning and management of the business and share its profits or losses. Section 12(a) lays down that "Subject to contract between the partners, every partner is entitled to take part in the conduct of the business of the firm". Such partner as actively participates in the firm's business, binds himself and other partners by all his acts done in

the usual course of partnership business. Such partner must give a public notice of his retirement from the firm in order to absolve (free) himself from liability for the acts of the other partners done after his retirement.

#### **(ii) Sleeping or Dormant Partner**

These partners invest money in the firm's business and take their share of profits but do not participate in the functioning and management of the business. But even then their liability is unlimited. The Act specially provides that if an act is binding on the firm, every partner is liable for it.

A sleeping partner can retire from the firm without giving any public notice to this effect. His liability for the acts of the firm ceases soon after retirement. Such partner has no duties to perform but is entitled to have access to books and accounts of the firm and he can have a copy of them.

#### **(iii) Nominal Partner**

Some people do not invest or participate in the management of the firm but only give their name to the business or firm. They are nominal partners but are liable to third parties for all the acts of the firm. Unlike a sleeping partner, they are known to the outsiders as partners in the firm, whereas actually they are not.

#### **(iv) Partner in Profits Only**

A partner who is entitled to share in the profits of a partnership firm without being liable to share the losses, is called a partner in profits only. Thus, a person who has sufficient capital but is not prepared to take risk may be admitted to the partnership by the other partners. Inspite of his specific position, he continues to be liable to the third parties for all acts of the firm, just like other parties.

#### **(v) Sub-Partner**

Where a partner agrees to share his profits in the firm with a third person, that third person is called a sub- partner. Such a sub-partner has no rights or duties towards the firm and does not carry any liability for the debts of the firm. Also he cannot bind the firm or other partners by his acts.

#### **(vi) Partner by Estoppel or Holding Out**

If the behaviour of a person arouses misunderstanding that he is a partner in a firm (when actually he is not), such a person is estopped from later on denying the liabilities for the acts of the firm. Such person is called partner by estoppel and is liable to all third parties.

Similarly, if a person who is declared to be a partner (when actually he is not) does not deny the fact that he is a partner, he being held out as a partner is responsible for all liability of the business. The law relating to partners by holding out is contained in Section 28 of the Act which lays down thus:

"Any one who by words, spoken or written or by conduct represents himself, or knowingly permits himself to be represented to be a partner in a firm, is liable as a partner in that firm to any one who has on the faith of any such representation given credit to the firm, whether the person representing himself or represented to be a partner does or does not know that the representation has reached the person so giving credit". The rule as to holding out is based on the doctrine of estoppel as contained in Section 115 of the Indian Evidence Act.

*Holding Out* means "to represent". Strangers, who hold themselves out or represent themselves to be partners in a firm, whereby they induce others to give credit to the partnership are called "Partners by Holding Out".

In case of "Partnership by Estoppel", the representation is made by partners about a stranger within his knowledge and hearing and he does not contradict it. He is then held liable as a partner.

#### *Effects of Holding out*

The Holding Out partner becomes personally and individually liable for the acts of the firm. But he does not become a partner in the firm and is not entitled to any rights or claim upon the firm. An outsider, who has given credit to the firm thinking him to be a partner, can hold him liable as if he is a partner in that firm. As the liability of the partners

is joint and several he can be held liable to pay the entire amount. But under the doctrine of subrogation as well as on the basis of quasi-contract, he can recover the amount so paid from the partners of the firm, if they are solvent.

#### *Exceptions to Holding Out*

The doctrine of Holding Out is not applicable in the following cases:

- (1) It does not apply to cases of torts committed by partners. A person, therefore, cannot be held liable for the torts of another simply because that other person held himself to be his partner.
- (2) It does not extend to bind the estate of a deceased partner, where after a partner's death the business of the firm is continued in the old firm name. [Section 28(2)]
- (3) It also does not apply where the Holding Out partner has been adjudicated insolvent. (Section 45)

#### **Minor Admitted to the Benefits of Partnership**

In view of Section 11 of the Indian Contract Act, 1872, and the decision of the Privy Council in *Nohori Bibi*

*Dharmo Das Ghose*, (1903) 30 I.A 114, a minor's agreement is altogether void and unenforceable. An

agreement is an essential ingredient in a partnership, it follows that a minor cannot enter into an agreement of partnership. On the same principle, a minor cannot be clothed with all the rights and obligations of a full-fledged partner through a guardian. Section 5 states "The relation of partnership arises from a contract..." The minor is incompetent to contract and, therefore, partnership cannot come into existence if the parties to a contract of partnership consist of one major and one minor. The only provision that Section 30 makes is that with the "consent of all the partners for the time being, a minor can be admitted into the benefits of partnership to which a minor is going to be admitted". A partnership firm cannot be formed with only minors as partners. There must be atleast two major partners before a minor is admitted into the benefits of partnership.

#### **Rights of Minor**

He is entitled to his agreed share and can inspect books of account of the firm [Section 30(2)]. He can bring a suit for account and his share when he intends to sever his connections with the firm, but not otherwise. [Section 30(4)]

A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to continue or repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

#### **Liabilities of Minor**

##### **1. His Share in Liability**

A minor partner's liability is confined only to the extent of his share in the firm. Section 30(3) provides that a minor's share is liable for the acts of the firm. But a minor is not personally liable in any such act. Thus, he is neither personally liable nor is his private estate liable for the acts of the firm.

##### **2. Personal Liabilities**

Where a minor on attaining majority, elects to become a partner, he becomes personally liable as other partners to the third parties for all the acts of the firm done since he was admitted to the benefits of partnership.

#### **Election by Minor**

A minor who was admitted to the benefits during his minority within six months of his attaining the age of majority or when he comes to know of his being so admitted (whichever date is later), he has to elect whether he wants to become a partner, or sever his connection with the firm. He may give public notice of his election to continue or

repudiate, but if he fails to give any public notice within the period stated above, he will be deemed to have elected to become a partner in the firm. [Section 30(5)]

***If he becomes or elects to become a partner, his position will be as under:***

1. His rights and liabilities will be similar to those of a full-fledged partner.
2. He will be personally liable for all the acts of the firm, done since he was first admitted to the benefits of the partnership.
3. His share of profits and property remains the same as was before, unless altered by agreement.

***If he elects not to become a partner, then:***

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

## **Relation of Partners to one another**

The relation of partnership arises through an agreement between the parties and such an agreement normally provides for mutual rights and obligations, or duties of the partners. Where, however, partnership arises by implication, or wherever the articles of partnership are silent, or where they do not exist, the rights and duties of partners are governed by the Act.

## **Rights of Partners**

Unless otherwise agreed by the partners, the following rules apply:

- (a) Every partner has a right to take part in the conduct and management of the business. [Section 12(a)]
- (b) Every partner whether active or dormant, has a right of free access to all records, books and accounts of the business and also to examine and copy them. [Section 12(d)]
- (c) Every partner is entitled to share in the profits equally, unless different proportions are stipulated. [Section 13(b)]
- (d) A partner who has contributed more than the share of the capital for the purpose of the business is entitled to an interest at a rate agreed upon, and where no rate is stipulated for, at six per cent per annum. But a partner cannot claim interest on capital, unless there is an agreement to pay it. [Section 13(d)]
- (e) A partner is entitled to be indemnified by the firm for all expenses incurred by him in the course of the business, for all payments made by him in respect of partnership debts or liabilities and disbursements made in an emergency for protecting the firm from loss. [Section 13(e)]
- (f) Every partner is, as a rule, a joint owner of the partnership property, and have it applied exclusively for the purposes of the partnership. (Section 15)
- (g) A partner has power to act in an emergency for protecting the firm from loss. (Section 21)
- (h) Every partner is entitled to prevent the introduction of a new partner into the firm without his consent. (Section 31)
- (i) Every partner has a right to retire by giving notice where the partnership is at will. [Section 32(1)(c)]
- (j) Every partner has a right to continue in the partnership and not to be expelled from it. [Section 33(1)]
- (k) An incoming partner will not be liable for any debts or liabilities of the firm before he becomes a partner. [Section 31(2)] (l)
- (l) Every outgoing partner has a right to carry on a competitive business under certain conditions. (Section 36)

## Duties of Partners

Apart from any duties imposed by the partnership articles, the following statutory duties are implied:

- (a) Every partner is bound to carry on the business of the firm to the greatest common advantage. (Section 9)
- (b) Every partner must be just and faithful to other partners. (Section 9)
- (c) A partner is bound to keep and render true, proper and correct accounts of the partnership. (Section 9)
- (d) Utmost good faith between the partners is the rule and one partner must not take advantage of the other. As an agent of other partners, every partner is bound to communicate full information to them. (Section 9)
- (e) Every partner must account for any benefits derived from the partnership business without the consent of the other partners, i.e., a partner must not make "secret profits". [Section 16(a)]
- (f) A partner must not compete with the firm, without the consent of the other partners. Any profits made by such unauthorised competition can be claimed by the firm. [Section 16(b)]
- (g) Every partner is bound to attend diligently to the business of the firm and in the absence of any agreement to the contrary, he is not entitled to receive any remuneration. [Section 12(b) and 13(a)]
- (h) In the absence of an agreement to the contrary, every partner is bound to share losses equally with the others. [Section 13(b)]
- (i) Every partner must hold and use the partnership property exclusively for the firm. (Section 15)
- (j) Every partner is bound to indemnify the firm for any loss caused by fraud in the conduct of the business. (Section 10)
- (k) A partner who is guilty of wilful neglect in the conduct of the business and the firm suffers loss in consequence, is bound to make compensation to the firm and other partners. [Section 13(f)]
- (l) No partner can assign or transfer his partnership interest to any other person, so as to make him a partner in the business. (Section 29)
- (m) But a partner may assign the profits and share in the partnership assets. But the assignee or transferee will have no right to ask for the accounts or to interfere in the management of the business; he would be entitled only to share the actual profits. On dissolution of the firm, he will be entitled to the share of the assets and also to accounts but only from the date of dissolution. (Section 29)
- (n) Every partner is bound to act within the scope of his actual authority. If he exceeds his authority, he shall compensate the other partners for loss unless they ratify his act.

## RELATION OF PARTNERS TO THIRD PARTIES

### Partners as Agents

Every partner is an agent of the firm and of other partners for the purpose of the business of the firm (Section 18). In the case of a partnership each partner is a principal and each one is an agent for the other partners. A partner is both a principal and an agent. Thus, the general law of agency is incorporated into the law of partnership. The law of partnership is often regarded as branch of the law of agency. The acts of every partner who does any act for carrying on in the usual way the business of the kind carried on by the firm bind the firm and his partners unless:

- (i) The partner so acting has no authority to act for the firm in that matter; and
- (ii) The person with whom he is dealing knows that he has no authority; or
- (iii) Does not know or believe him to be a partner.

### Authority of a Partner

The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.

**(i) Express Authority:** - Authority is said to be express when it is given by words, spoken or written. The firm is bound by all acts of a partner done within the scope of his express authority even if the acts are not within the scope of the partnership business.

**(ii) Implied Authority:** - The implied authority of a partner is also known as ostensible or apparent authority, Sections 19 and 22 contain provisions regarding the scope of the implied authority of a partner. The implied authority is subject to the following conditions:

1. the act done must relate to the "normal business" of the firm;
2. the act must be done in the usual way;
3. the act must be done in the name of the firm.

### Implied Authority of a Partner

Subject to the limitations mentioned above, every partner has an implied authority to bind the firm by the following acts:

- (i) By selling firm's goods;
- (ii) By purchasing goods for the firm;
- (iii) By accepting any payment of debts due to the firm; and
- (iv) By engaging and discharging employees.

In a Trading Firm (one which carries on business of buying and selling goods), a partner has the following additional powers:

- (i) To borrow money on the firm's credit and to pledge the firm's goods for that purpose;
- (ii) To accept, make and issue negotiable instruments in the firm's name; and
- (iii) To employ a solicitor or attorney on behalf of the firm (Bank of Australasia v. Beriliat, (1847) 6 Moor, P.C. 152 at pp. 193-94).

### Acts beyond Implied Authority

Section 19(2) states that in the absence of any usage or custom or trade to the contrary, the implied authority of a partner does not empower him to:

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

### Extent of Partners' Liability

It is, however, open to the partners by means of an express contract to extend or limit the implied authority, but third parties will be bound by such limitations only when they have notice of such curtailment.

All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts (Section 25). This is known as the liability of partners for the acts of the firm. But in order that an act done may be an act of the firm and, therefore, binding on the firm, it is necessary that the partner doing the act on behalf of the firm must have done that act in the name of and on behalf of the firm and not in his personal capacity. And the act must have been done in the ordinary course of the business of the firm. [Sections 19(1) and 22]

### **Liability of the Firm for Torts**

Every partner is liable for the negligence and fraud of the other partners in the course of the management of business. A partner charges the firm if he acts as an agent for it. The firm is similarly liable where a partner commits a tort with the authority of his co-partners. (Section 26)

If a partner acting within the scope of his apparent authority receives the property of a third person and misapplies it, or if the firm in the course of its business receives the property of a third person and, while it is in the firm's custody, a partner misapplies it, in each case the firm is liable to make good the loss. (Section 27)

### **Liability of an Incoming Partner**

As a general rule, an incoming partner is not liable for the debts incurred before he joined the firm as a partner [Section 31(2)]. The incoming partner may, however, assume liability for past debts by novation, i.e., by a tripartite agreement between (i) the creditor of the firm, (ii) the partners existing at the time the debt was incurred, and (iii) the incoming partner.

### **Liability of an Outgoing or Retiring Partner**

An outgoing partner remains liable for the partnership debts contracted while he was a partner. He may, however, be discharged by novation, i.e., by an agreement between himself, the new firm and the creditors. He may also continue to be liable after retirement if he allows himself to be held out as a partner, e.g. by allowing his name to remain the firm name. To protect himself from his liability, he should give express notice of his retirement to the persons who were dealing with the firm before his retirement or give public notice in the manner as laid down in Section 72 of the Act, that is to say, by publishing it in the Official Gazette and in at least one vernacular newspaper where the firm carries on the business. [Section 32(3)]

### **Death or Insolvency**

The estate of a partner who dies, or who becomes insolvent, is not liable for partnership debts contracted after the date of the death or insolvency. It will, however, be liable for debts incurred before death or insolvency. (Sections 34 and 35)

### **Dissolution**

According to Section 39 "The dissolution of partnership between all the partners of a firm" is called the "Dissolution of the Firm". A dissolution does not necessarily follow because the partnership has ceased to do business, for the partnership may continue for the purpose of realising the assets.

The Partnership Act makes a distinction between the "dissolution of partnership" and "dissolution of firm". Where there is dissolution of partnership between all the partners of a firm, it is a dissolution of the firm (Section 39). Where there is an extinction of relationship between some of the partners only, it is a dissolution of partnership. So the dissolution of a partnership may or may not include the dissolution of the firm, but the dissolution of the firm necessarily means the dissolution of the partnership as well.

### Dissolution of Partnership

The dissolution of partnership takes place (even when there is no dissolution of the firm) in the following circumstances:

- (a) By the expiry of the fixed term for which the partnership was formed.[Section 42(a)]
- (b) By the completion of the adventure. [Section 42(b)]
- (c) By the death of a partner. [Section 42(c)]
- (d) By the insolvency of a partner. [Section 42(d)]
- (e) By the retirement of a partner. [Section 42(e)]

In all the above cases, the remaining partners may continue the firm in pursuance of an agreement to that effect. If they do not continue then the dissolution of the firm takes place automatically.

### Dissolution of the Firm

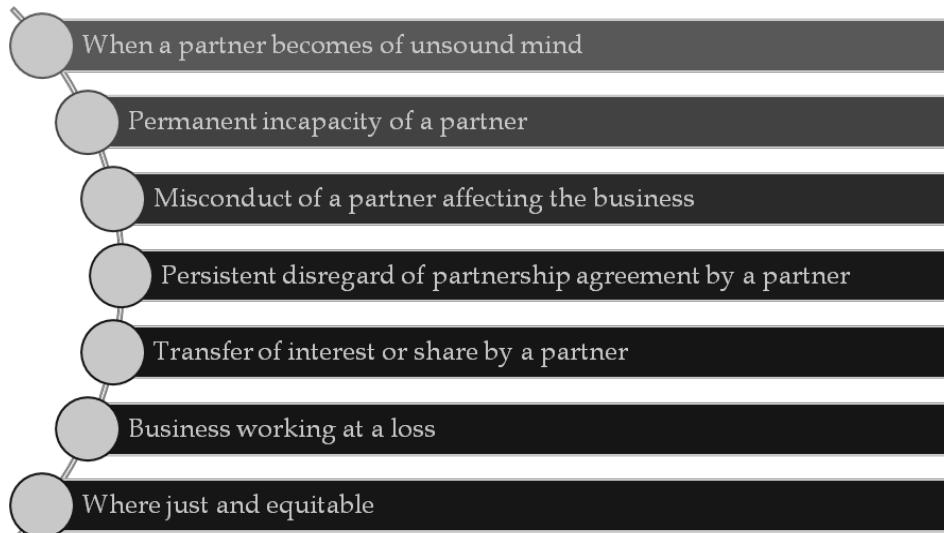
In the following cases there is necessarily a breaking up or extinction of the relationship between all the partners of the firm, and closing up of the business:

- (a) By mutual agreement: A firm may be dissolved where all the partners agree that it shall be dissolved. (Section 40)
- (b) By the insolvency of all the partners but one: If all the partners except one become insolvent, the firm must come to an end, as a partnership firm with one partner cannot continue. [Section 41(a)]
- (c) By business becoming illegal: If the business of the firm becomes illegal because of some subsequent events, such as change of law, it is automatically or compulsorily dissolved by the operation of law. [Section 41(b)]
- (d) By notice of dissolution: Where the partnership is at will, the firm may be dissolved at any time, by any partner giving notice in writing of his intention to dissolve the firm, to all the other partners. The dissolution will take place from the date mentioned in the notice or, if no such date is mentioned, as from the date of the communication of the notice. (Section 43)

### Dissolution of the Firm through Court

Unlike a partnership at will, the partnership for a fixed period cannot be dissolved by a notice. It could only be dissolved by Court in a suit by a partner. Though remedy of dissolution by a suit is available in case of all kinds of partnership, it is of practical importance in case of partnership for a fixed period.

**As per Section 44, the Court may order dissolution of the firm in the following circumstances:**



- (a) When a partner becomes of unsound mind: As the insanity of a partner does not automatically dissolve the firm, either the lunatic through his guardian or other partners may file a suit for the dissolution of the firm, in either case the Court may order dissolution which will take effect from the date of the order.
- (b) Permanent incapacity of a partner: Where a partner has become permanently incapable of performing his duties as a partner, e.g., he becomes blind, paralytic, etc., the Court may, at the instance of any of the other partners, order the dissolution of the firm.
- (c) Misconduct of a partner affecting the business: Where a partner is guilty of misconduct, which is likely to affect prejudicially the business of the firm, the Court may dissolve the firm at the instance of any of the other partners. Gambling by a partner or conviction of a partner for travelling without ticket would be sufficient ground for dissolution.
- (d) Persistent disregard of partnership agreement by a partner: Where a partner frequently commits breaches of the partnership agreement and the other partners find it impossible to carry on the business, the Court may order dissolution at the instance of the other partners.
- (e) Transfer of interest or share by a partner: A partner is not entitled to assign away his interest so as to introduce a new partner into the firm. Where a partner has transferred the whole of his interest to a third person or where his interest has been attached under a decree or sold under a process of law, the other partners may sue for dissolution.
- (f) Business working at a loss: The Court may dissolve a partnership firm where it is satisfied that the business of the firm cannot be carried on except at a loss.
- (g) Where just and equitable: As the grounds mentioned are not exhaustive, the Court may dissolve a firm on any other ground if it is satisfied that it would be just and equitable to dissolve the firm. The Court may order dissolution where the sub-stratum of the partnership firm has gone or where there is a complete deadlock and destruction of confidence between the partners [*re. Yenidje Tobacco Co. Ltd. (1916) 2 Ch. 426*].

## **Effect of Dissolution**

### ***Continuing authority of partners***

The authority of partners to bind the firm continues so long as is necessary to wind up the business, provided that the firm is in no case bound by the acts of a partner who has been adjudged an insolvent except on the principle of holding out. (Section 47)

Also each partner has an equitable lien over the firm's assets entitling him to have them applied in payment of the firm's debts, and in payment of whatever is due to partner. This lien can be enforced by injunction forbidding unfair distribution. (Section 46)

### ***Continuing liability of partners***

The partners continue to be liable to outsiders for any act done by any of them which would have been an act of the firm if done before the dissolution, unless a public notice is given of the dissolution.

After dissolution, the rights and obligations of partners continue in all things necessary for the winding up of the business. The partners may complete unfinished transactions. But this authority is only for the winding up of the affairs of the firm and not for new transactions.

### ***Right to Return of Premium***

To buy entry into an existing firm, a new partner sometimes has to pay a premium to the existing partners in addition to any investment of capital. On dissolution, he is entitled to demand the return of a proportion of the premium if the partnership was for a fixed term and was dissolved before the expiry of that term, unless dissolution was caused by (i) agreement, or (ii) misconduct of the party seeking return of the premium, or (iii) death of a partner. (Section 51)

### ***Settlement of Accounts on Dissolution***

Section 48 of the Act provides that in settling accounts between the partners after a dissolution of partnership, the following rules shall, subject to any agreement, be observed:

- (a) Losses, including deficiencies of capital shall be paid first out of undistributed profits, next out of capital, and lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits
- (b) The assets of the firm, including the sums, contributed by the partners to make up losses or deficiencies of capital shall be applied in the following manner and order:
  - (i) in paying outside creditors;
  - (ii) in repaying advances made by partners (distinct from investment of capital);
  - (iii) in repaying capital to partners; and
  - (iv) the ultimate residue, if any, shall be divided among the partners in the proportions in which profits are divisible.

Where the assets are not sufficient, the partners have to bear the loss in equal shares. After they have contributed their share of the deficiency they will be paid rateably the amount due to them by way of their capital (The Rule followed in the case of *Garner v. Murray*, 1904 73 L.J. Ch. 66).

### ***Loss due to insolvency of partners***

In case a partner is insolvent and is not able to contribute towards the deficiency, the principle laid down in the case of *Garner vs. Murray* will be applicable.

#### **It holds that:**

- (a) The solvent partners will contribute only their share of deficiency in cash
- (b) The available assets should be distributed among the solvent partners in proportion to their capital.
- (c) Thus, the deficiency of capital of the insolvent partners will be distributed among the solvent partners in the ratio of their respective capitals.

### **Goodwill**

This is a partnership asset and means the benefit arising from a firm's business connections or reputation. "It is the advantage which is acquired by a business, beyond the mere value of the capital, stock fund and properly employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers". Though an intangible asset, it has value; and unless otherwise agreed in the partnership articles, upon dissolution it must be sold and the proceeds of sale distributed as capital. Where dissolution is caused by death, the estate of the deceased partner is entitled to share in the proceeds of the sale.

If the goodwill is sold and there is no agreement as to its disposal, any partner can carry on the business, provided that by doing so he does not expose former partners to liability. But if by agreement the goodwill is assigned to any person, he can restrain partners as explained in the next para.

### Sale of Goodwill

Where goodwill is sold, either to a partner or to an outsider, the value is divisible among the partners in the same manner as they share profits and losses, unless otherwise agreed.

The rights of the buyer and seller of the goodwill are as follows:

- (a) Buyer's rights: On the sale of goodwill the buyer may, unless the terms in the contract of sale provide otherwise:
  - (i) represent himself in continuing the business,
  - (ii) maintain his exclusive rights to the use of the firm name, and
  - (iii) solicit former customers of the business and restrain the seller of the goodwill from doing so.
- (b) Seller's rights: The vendors may enter into competition with the purchaser unless he is prevented by a valid restraint clause in the contract of sale.

### Registration of the Firm

Section 56-71 deal with the registration of a firm and consequences of non-registration.

#### Registration

The registration of a firm may be effected at any time by sending by post or delivering to the Registrar of the area in which any place of business of the firm is situated or proposed to be situated, a statement in the prescribed form and accompanied by the prescribed fee, stating:

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

The statement shall be signed and verified by all the partners or by their agents specially authorised in this behalf. (Section 58)

The Partnership Act, 1932, does not make registration of a firm compulsory but it introduces certain disabilities, which makes registration necessary at one time or other. An unregistered firm is not an illegal association.

#### Effects of Non-registration

The following are the effects of non-registration of a firm:

1. Sub-section (1) of Section 69 places a bar on the right of the partners of a firm to sue each other or the firm for enforcing any right arising from a contract or conferred by the Partnership Act, if the firm is not registered and the person suing is or has not been shown in the Register of Firms as a partner in the firm.
2. Sub-section (2) of Section 69 places a bar on the institution of a suit by or on behalf of a firm against a third-party if the firm is not registered and the persons suing are or have not been shown in the Register of Firms as partners in the firm.
3. There is no bar on the right of third-parties to sue the firm or any partner. However, the Act allows the following suits:
  - (a) A suit for the dissolution of a firm.
  - (b) A suit for rendering of accounts of a dissolved firm.

- (c) A suit for realisation of the property of a dissolved firm.
- (d) A suit or claim of set-off, the value of which does not exceed one hundred rupees,
- (e) A proceeding in execution or other proceeding incidental to or arising from a suit or claim for not exceeding one hundred rupees in value.
- (f) A suit by a firm which has no place of business in the territories to which the Indian Partnership Act extends.
- (g) A suit for the realisation of the property of an insolvent partner.
- (h) A suit by a firm whose places of business are situated in areas which are exempted from the application of Chapter VII of the Indian Partnership Act, 1932.

Section 69 bars the very institution of a suit by an unregistered firm or by its partners. Registration is a condition precedent to the right to institute the suit and, therefore, the condition precedent must first be fulfilled before the institution of the suit. If, therefore, on the date of the institution of a suit, the firm is not registered, the subsequent registration cannot validate the suit. The only option left to the Court is to dismiss the suit (*Prithvi Singh vs. Hasan Ali*, (1950) Bom. L.R. 862). By virtue of this provision a partner of an unregistered firm cannot institute a suit to compel the other partner or partners to join in the registration of firm. The only remedy of such a partner is to institute a suit for dissolution (*Keshav Lal vs. Chuni Lal*, AIR 1941 Rangoon 196). A suit by the firm is really a suit by all the partners who were its partners at the time of the accrual of the cause of action and, therefore, all must join in the institution of the suit.

However, an unregistered firm can bring a suit to enforce a right arising otherwise than out of contract e.g., for an injunction against a person for wrongful infringement of trade mark etc.

### Specific Performance of Partnership Agreement

It is not allowed. The working of a partnership depends upon the personal inclination of the partners, there can be no specific performance of a partnership agreement (*Scott v. Raymont*, 1868, 7 Fq. 112).

### Suit for Libel or Slander

A firm is merely a collection of partners and cannot bring a suit for libel or slander. Libel or slander against a firm imply a libel or slander of its partners. Such partners themselves or any one may file the suit for libel or slander (*P.K. Oswal Hosiery Mills v. Tilak Chand*, AIR 1969, Punj. 150).

#### LESSON ROUND-UP

- The Indian Partnership Act, 1932 lays down the important provisions relating to partnership contracts.
- According to Section 4 "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all."
- A partnership may either be for a particular adventure or for a fixed period. It may also be a partnership at will.
- The minor is incompetent to contract and, therefore, partnership cannot come into existence if the parties to a contract of partnership consist of one major and one minor.
- Every partner is an agent of the firm and of other partners for the purpose of the business of the firm.
- The authority of a partner means the capacity of a partner to bind the firm by his act. This authority may be express or implied.
- All partners are liable jointly and severally for all acts or omissions binding on the firm including liabilities arising from contracts as well as torts.
- The dissolution of partnership between all the partners of a firm is called the "Dissolution of the Firm".
- A dissolution does not necessarily follow because the partnership has ceased to do business, for the partnership may continue for the purpose of realising the assets.

### TEST YOURSELF

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Describe the essentials of partnership. What is the true test of partnership?
2. What is the position of a minor in a partnership?
3. Discuss the liability of partners inter se.
4. Whether registration of a firm is compulsory? Discuss the effects of non-registration.
5. Briefly discuss the provisions relating to the dissolution of partnership or firm and what are its effects?

# Negotiable Instruments Act, 1881

## Lesson 24

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### ***Key Concepts One Should Know***

- Negotiable Instrument
- Bouncing of Cheques
- Dishonour of Cheques
- Instruments

### ***Learning Objectives***

#### **To understand:**

- Negotiable Instruments and Parties
- Effect of Negotiability
- Crossing and Bouncing of Cheques;
- Dishonour of Cheques & its Remedies
- Presumption of Law as to Negotiable Instruments

### ***Regulatory Framework***

- Negotiable Instruments Act, 1881

### ***Lesson Outline***

- Negotiable Instruments and Parties
- Alteration
- Crossing and bouncing of Cheques
- Dishonour of Cheques & its Remedies
- Presumption of Law as to Negotiable Instruments
- Inchoate Instrument
- Negotiation
- National Electronic Funds Transfer (NEFT)
- Real Time Gross Settlement (RTGS)
- LESSON ROUND-UP
- TEST YOURSELF

## DEFINITION OF A NEGOTIABLE INSTRUMENT

The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques.

The Act does not affect the custom or local usage relating to an instrument in oriental language i.e., a Hundi.

The term "*negotiable instrument*" means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer. [Section 13(1)]

A negotiable instrument may be defined as "an instrument, the property in which is acquired by anyone who takes it bona fide, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument" (*Willis—The Law of Negotiable Securities, Page 6*).

According to this definition the following are the conditions of negotiability:

- (i) The instrument should be freely transferable. An instrument cannot be negotiable unless it is such and in such state that the true owner could transfer by simple delivery or endorsement and delivery.
- (ii) The person who takes it for value and in good faith is not affected by the defect in the title of the transferor.
- (iii) Such a person can sue upon the instrument in his own name.

Negotiability involves two elements namely, transferability free from equities and transferability by delivery or endorsement (Mookerjee J. In *Tailors Priya vs. Gulab Chand*, AIR 1965 Cal).

But the Act recognises only three types of instruments viz., a Promissory Note, a Bill of Exchange and a Cheque as negotiable instruments. However, it does not mean that other instruments are not negotiable instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade. Transferability may be by (i) delivery or (ii) endorsement and delivery.
2. The person who obtains it in good faith and for consideration gets it free from all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the maturity.

## Effect of Negotiability

The general principle of law relating to transfer of property is that no one can pass a better title than he himself has (*nemodat quad non-habet*). The exceptions to this general rule arise by virtue of statute or by a custom. A negotiable instrument is one such exception which is originally a creation of mercantile custom.

Thus a *bona fide* transferee of negotiable instrument for consideration without notice of any defect of title, acquires the instrument free of any defect, i.e., he acquires a better title than that of the transferor.

## IMPORTANT CHARACTERISTICS OF NEGOTIABLE INSTRUMENTS

*Following are the important characteristics of negotiable instruments:*

The holder of the instrument is presumed to be the owner of the property contained in it

They are freely transferable

A holder in due course gets the instrument free from all defects of title of any previous holder

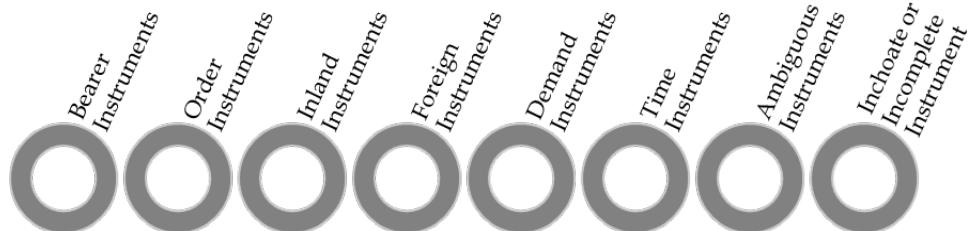
The holder in due course is entitled to sue on the instrument in his own name

The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue)

Certain equal presumptions are applicable to all negotiable instruments unless the contrary is proved

## Classification of Negotiable Instruments

The negotiable instruments may be classified as under:



### 1. Bearer Instruments

A promissory note, bill of exchange or cheque is payable to bearer when (i) it is expressed to be so payable, or (ii) the only or last endorsement on the instrument is an endorsement in blank. A person who is a holder of a bearer instrument can obtain the payment of the instrument.

### 2. Order Instruments

A promissory note, bill of exchange or cheque is payable to order (i) which is expressed to be so payable; or (ii) which is expressed to be payable to a particular person, and does not contain any words prohibiting transfer or indicating an intention that it shall not be transferable.

### 3. Inland Instruments (Section 11)

A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

1. drawn and made payable in India, or
2. drawn in India upon some persons resident therein, even though it is made payable in a foreign country.

#### 4. Foreign Instruments

An instrument which is not an inland instrument, is deemed to be a foreign instrument. The essentials of a foreign instrument include that:

- (i) it must be drawn outside India and made payable outside or inside India; or
- (ii) it must be drawn in India and made payable outside India and drawn on a person resident outside India.

#### 5. Demand Instruments (Section 19)

A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

#### 6. Time Instruments

Time instruments are those which are payable at sometime in the future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on specified day, or on the happening of an event which is certain to happen, is known as a time instrument. The expression "after sight" in a promissory note means that the payment cannot be demanded on it unless it has been shown to the maker. In the case of bill of exchange, the expression "after sight" means after acceptance, or after noting for non-acceptance or after protest for non-acceptance.

#### Ambiguous Instruments (Section 17)

An instrument, which in form is such that it may either be treated by the holder as a bill or as a note, is an ambiguous instrument. Section 5(2) of the English Bills of Exchange Act provides that where in a bill, the drawer and the drawee are the same person or where the drawee is a fictitious person or a person incompetent to contract, the holder may treat the instrument, at his option, either as a bill of exchange or as a promissory note.

Bill drawn to or to the order of the drawee or by an agent on his principal, or by one branch of a bank on another or by the direction of a company or their cashier are also ambiguous instruments. A promissory note addressed to a third person may be treated as a bill by such person by accepting it, while a bill not addressed to any one may be treated as a note. But where the drawer and payee are the same, e.g., where A draws a bill payable to A's order, it is not an ambiguous instrument and cannot be treated as a promissory note. Once an instrument has been treated either as a bill or as a note, it cannot be treated differently afterwards.

#### Inchoate or Incomplete Instrument (Section 20)

When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered by the stamp. Such an instrument is called an inchoate instrument. The person so signing shall be liable upon such instrument, in the capacity in which he signs the same, to any holder in due course for such amount, provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount intended by him to be paid thereon.

The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due-course". But there is a difference in their respective rights. A "holder" can recover only what the person signing and delivering the paper agreed to pay under the instrument, while a "holder-in-due-course" can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller.

#### KINDS OF NEGOTIABLE INSTRUMENTS

The Act recognises only three kinds of negotiable instruments under Section 13 but it does not exclude any other negotiable instrument provided the instrument entitles a person to a sum of money and is transferable by delivery. Instruments written in oriental languages i.e. hundis are also negotiable instruments. These instruments are discussed below:

## (i) Promissory Notes

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 to, or to the order of, a certain person, or only to bearer of the instrument. (Section 4)

### Parties to a Promissory Note:

***A promissory note has the following parties:***

- (a) The maker: the person who makes or executes the note promising to pay the amount stated therein.
- (b) The payee: one to whom the note is payable.
- (c) The holder: is either the payee or some other person to whom he may have endorsed the note.
- (d) The endorser.
- (e) The endorsee.

### Essentials of a Promissory Note:

To be a promissory note, an instrument must possess the following essentials:

- (a) It must be in writing. An oral promise to pay will not do.
- (b) It must contain an express promise or clear undertaking to pay. A promise to pay cannot be inferred. A mere acknowledgement of debt is not sufficient. If A writes to B “I owe you (I.O.U.) Rs. 500”, there is no promise to pay and the instrument is not a promissory note.
- (c) The promise or undertaking to pay must be unconditional. A promise to pay “when able”, or “as soon as possible”, or “after your marriage to D”, is conditional. But a promise to pay after a specific time or on the happening of an event which must happen, is not conditional, e.g. “I promise to pay Rs. 1,000 ten days after the death of B”, is unconditional.
- (d) The maker must sign the promissory note in token of an undertaking to pay to the payee or his order.
- (e) The maker must be a certain person, i.e., the note must show clearly who is the person engaging himself to pay.
- (f) The payee must be certain. The promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order.
- (g) The sum payable must be certain and the amount must not be capable of contingent additions or subtractions. If A promises to pay Rs. 100 and all other sums which shall become due to him, the instrument is not a promissory note.
- (h) Payment must be in legal money of the country. Thus, a promise to pay Rs. 500 and deliver 10 quintals of rice is not a promissory note.
- (i) It must be properly stamped in accordance with the provisions of the Indian Stamp Act, 1899. Each stamp must be duly cancelled by maker’s signature or initials.
- (j) It must contain the name of place, number and the date on which it is made. However, their omission will not render the instrument invalid, e.g. if it is undated, it is deemed to be dated on the date of delivery.

Note: A promissory note cannot be made payable or issued to bearer, no matter whether it is payable on demand or after a certain time (Section 31 of the RBI Act, 1934).

## (ii) Bills of Exchange

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. (Section 5)

The definition of a bill of exchange is very similar to that of a promissory note and for most of the cases the rules which apply to promissory notes are in general applicable to bills. There are however, certain important points of distinction between the two.

## Parties to bills of exchange

*The following are parties to a bill of exchange:*

- (a) The Drawer: the person who draws the bill.
- (b) The Drawee: the person on whom the bill is drawn.
- (c) The Acceptor: one who accepts the bill. Generally, the drawee is the acceptor but a stranger may accept it on behalf of the drawee.
- (d) The payee: one to whom the sum stated in the bill is payable, either the drawer or any other person may be the payee.
- (e) The holder: is either the original payee or any other person to whom, the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.
- (f) The endorser: when the holder endorses the bill to any one else he becomes the endorser.
- (g) The endorsee: is the person to whom the bill is endorsed.
- (h) Drawee in case of need: Besides the above parties, another person called the “drawee in case of need”, may be introduced at the option of the drawer. The name of such a person may be inserted either by the drawer or by any endorser in order that resort may be had to him in case of need, i.e., when the bill is dishonoured by either non-acceptance or non-payment.
- (i) Acceptor for honour: Further, any person may voluntarily become a party to a bill as acceptor. A person, who on the refusal by the original drawee to accept the bill or to furnish better security, when demanded by the notary, accept the bill supra protest in order to safeguard the honour of the drawer or any endorser, is called the acceptor for honour.

### Essentials of a Bill of Exchange:

- (1) It must be in writing.
- (2) It must contain an unconditional order to pay money only and not merely a request.
- (3) It must be signed by the drawer.
- (4) The parties must be certain.
- (5) The sum payable must also be certain.
- (6) It must comply with other formalities e.g. stamps, date, etc.

## Distinction between Bill of Exchange and Promissory Note

The following are the important points of distinction between a bill of exchange and a promissory note:

- (a) A promissory note is a two-party instrument, with a maker (debtor) and a payee (creditor). In a bill there are three parties—drawer, drawee and payee, though any two out of the three capacities may be filled by one and the same person. In a bill, the drawer is the maker who orders the drawee to pay the bill to a person called the payee or to his order. When the drawee accepts the bill he is called the acceptor.
- (b) A note cannot be made payable to the maker himself, while in a bill, the drawer and payee may be the same person.
- (c) A note contains an unconditional promise by the maker to pay to the payee or his order; in a bill there is an unconditional order to the drawee to pay according to the directions of the drawer.
- (d) A note is presented for payment without any prior acceptance by the maker. A bill payable after sight must be accepted by the drawee or someone else on his behalf before it can be presented for payment.

- (e) The liability of the maker of a pro-note is primary and absolute, but the liability of the drawer of a bill is secondary and conditional.
- (f) Foreign bill must be protested for dishonour but no such protest is necessary in the case of a note.
- (g) When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate endorsee, but no such notice need to be given in the case of a note.
- (h) A bill can be drawn payable to bearer provided it is not payable on demand. A promissory note cannot be made payable to bearer, even if it is made payable otherwise than on demand.

### How Bill of Exchange Originates—Forms of Bills of Exchange

Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.

### Inland Bills (Sections 11 and 12)

A bill of exchange is an inland instrument if it is (i) drawn or made and payable in India, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country. But a promissory note to be an inland should be drawn and payable in India, as it has no drawee.

Two essential conditions to make an inland instrument are:

- (i) the instrument must have been drawn or made in India; and
- (ii) the instrument must be payable in India or the drawee must be in India.

*Examples:* A bill drawn in India, payable in USA, upon a person in India is an inland instrument. A bill drawn in India and payable in India but drawn on a person in USA is also an inland instrument.

### Foreign Bills

All bills which are not inland are deemed to be foreign bills. Normally foreign bills are drawn in sets of three copies.

### Trade Bill

A bill drawn and accepted for a genuine trade transaction is termed as a trade bill. When a trader sells goods on credit, he may make use of a bill of exchange. Suppose A sells goods worth Rs. 1,000 to B and allows him 90 days time to pay the price, A will draw a bill of exchange on B, on the following terms: "Ninety days after date pay A or order, the sum of one thousand rupees only for value received". A will sign the bill and then present it to B for acceptance. This is necessary because, until a bill is accepted by the drawee, nobody has either rights or obligations. If B agrees to obey the order of A, he will accept the bill by writing across its face the word "accepted" and signing his name underneath and then delivering the bill to the holder. B, the drawee, now becomes the acceptor of the bill and liable to its holders. Such a bill is a genuine trade bill.

### Accommodation Bill

All bills are not genuine trade bills, as they are often drawn for accommodating a party. An accommodation bill is a bill in which a person lends or gives his name to oblige a friend or some person whom he knows or otherwise. In other words, a bill which is drawn, accepted or endorsed without consideration is called an accommodation bill. The party lending his name to oblige the other party is known as the accommodating or accommodation party, and the party so obliged is called the party accommodated. An accommodation party is not liable on the instrument to the party accommodated because as between them there was no consideration and the instrument was merely to help. But the accommodation party is liable to a holder for value, who takes the accommodation bill for value, though such holder may not be a holder in due course. Thus, A may be in need of money and approach his friends B and C who, instead of lending the money directly, propose to draw an "Accommodation Bill" in his favour in the following form:

"Three months after date pay A or order, the sum of Rupees one thousand only".

B.

To

C.

If the credit of B and C is good, this device enables A to get an advance of `1,000 from his banker at the commercial rate of discount. The real debtor in this case is not C, but A the payee who promises to reimburse C before the period of three months only. A is here the principal debtor and B and C are mere sureties. This inversion of liability affords a good definition of an accommodation bill: "If as between the original parties to the bill the one who should *prima facie* be principal is in fact the surety whether he be drawer, acceptor, or endorser, that bill is an accommodation bill".

### **Bills in Sets (Section 132 and 133)**

Foreign bills are usually drawn in sets to avoid the danger of loss. They are drawn in sets of three, each of which is called "Via" and as soon as any one of them is paid, the others become inoperative. All these parts form one bill and the drawer must sign and deliver all of them to the payee. The stamp is affixed only on one part and one part is required to be accepted. But if the drawer mistakenly accepts all the parts of the same bill, he will be liable on each part accepted as if it were a separate bill.

### **Right to Duplicate Bill**

Where a bill of exchange has been lost before it was overdue, the person who was the holder to it may apply to the drawer, to give him another bill of the same tenor. It is only the holder who can ask for a duplicate bill, promissory note or cheque.

### **Bank Draft**

A bill of exchange is also sometimes spoken of as a draft. It is called as a bank draft when a bill of exchange drawn by one bank on another bank, or by itself on its own branch, and is a negotiable instrument. It is very much like the cheque with three points of distinction between the two. A bank draft can be drawn only by a bank on another bank, usually its own branch. It cannot so easily be countermanded. It cannot be made payable to bearer.

### **Specimen of a Bank Draft**

A.B.C. Bank

X.Y.Z. Branch

No.....

Date.....

On demand pay 'A' or order the sum of rupees one thousand five hundred only for value received.

Rs.1,500/-

Sd./- Manager

To

'B' Branch, (Place)

In the above demand draft, the drawer is X.Y.Z. Branch, the drawee is 'B' branch and the payee is 'A'.

### **(iii) Cheques**

The Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002 and Negotiable Instrument (Amendment) Act, 2015 have broadened, the definition of cheque to include the electronic image of a truncated cheque and a cheque in the electronic form. Section 6 of the Act provides that a 'cheque' is a bill of exchange drawn

on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

Despite the amendment as is evident the basic definition of the cheque has been retained and the definition has only been enlarged to include cheques in the above form as well.

As per explanation appended to the section, the expression:

- (i) “a cheque in the electronic form” means a cheque drawn in electronic form by using any computer resource and signed in a secure system with digital signature (with or without biometrics signature) and asymmetric crypto system or with electronic signature, as the case may be;
- (ii) ‘a truncated cheque’ means a cheque which is truncated during the course of a clearing cycle, either by the clearing house or by the bank whether paying or receiving payment, immediately on generation of an electronic image for transmission, substituting the further physical movement of the cheque in writing. (Explanation I).

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. (*Explanation II*).

**Explanation III.** – For the purposes of this section, the expressions “asymmetric crypto system”, “computer resource”, “digital signature”, “electronic form” and “electronic signature” shall have the same meanings respectively assigned to them in the Information Technology Act, 2000.’

Simply stated, a cheque is a bill of exchange drawn on a bank payable always on demand. Thus, a cheque is a bill of exchange with two additional qualifications, namely: (i) it is always drawn on a banker, and (ii) it is always payable on demand. A cheque being a species of a bill of exchange, must satisfy all the requirements of a bill; it does not, however, require acceptance.

**Note:** By virtue of Section 31 of the Reserve Bank of India Act, no bill of exchange or hundi can be made payable to bearer on demand and no promissory note or a bank draft can be made payable to bearer at all, whether on demand or after a specified time. Only a cheque can be payable to bearer on demand.

### Parties to a cheque

The following are the parties to a cheque:

- The drawer: The person who draws the cheque.
- The drawee: The banker of the drawer on whom the cheque is drawn.
- The payee, holder, endorser and endorsee: same as in the case of a bill.

### Essentials of a Cheque

- (1) It is always drawn on a banker.
- (2) It is always payable on demand.
- (3) It does not require acceptance. There is, however, a custom among banks to mark cheques as good for purposes of clearance.
- (4) A cheque can be drawn on bank where the drawer has an account.
- (5) Cheques may be payable to the drawer himself. It may be made payable to bearer on demand unlike a bill or a note.
- (6) The banker is liable only to the drawer. A holder has no remedy against the banker if a cheque is dishonoured.
- (7) A cheque is usually valid for six months. However, it is not invalid if it is post dated or ante-dated.
- (8) No stamp is required to be affixed on cheques.

### Distinction between Cheques and Bills of Exchange

As a general rule, the provisions applicable to bills payable on demand apply to cheques, yet there are few points of distinction between the two, namely:

- (a) A cheque is a bill of exchange and always drawn on a banker, while a bill may be drawn on any one, including banker.
- (b) A cheque can only be drawn payable on demand, a bill may be drawn payable on demand, or on the expiry of a specified period after sight or date.
- (c) A bill payable after sight must be accepted before payment can be demanded, a cheque does not require acceptance and is intended for immediate payment.
- (d) A grace of 3 days is allowed in the case of time bills, while no grace is given in the case of a cheque, for payment.
- (e) The drawer of a bill is discharged, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presentment for payment.
- (f) Notice of the dishonour of a bill is necessary, but not in the case of a cheque.
- (g) The cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of bill.
- (h) A cheque may be crossed, but not a bill.

A cheque is a bill of exchange drawn on a specified banker and always payable on demand. A cheque is always drawn on a particular banker and is always payable on demand. Consequently, all cheques are bills of exchange but all bills are not cheques.

### Specimen of a Cheque

A.B.C. Bank

X.Y.Z. Branch

Date.....

Pay 'A'..... or the bearer sum of rupees only.

Rs. /-

A/c No..... LF.....

No.....

Sd/-

### Banker

A banker is one who does banking business. Section 5(b) of the Banking Regulation Act, 1949 defines banking as, "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft or otherwise." This definition emphasises two points: (1) that the primary function of a banker consists of accepting of deposits for the purpose of lending or investing the same; (2) that the amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order.

### Customer

The term "customer" is neither defined in Indian nor in English statutes. The general opinion is that a customer is one who has an account with the bank or who utilises the services of the bank.

The special features of the legal relationship between the banker and the customer may be termed as the obligations and rights of the banker. These are:

1. Obligation to honour cheques of the customers.
2. Obligation to collect cheques and drafts on behalf of the customers.
3. Obligation to keep proper record of transactions with the customer.
4. Obligation to comply with the express standing instructions of the customer.
5. Obligation not to disclose the state of customer's account to anyone else.
6. Obligation to give reasonable notice to the customer, if the banker wishes to close the account.
7. Right of lien over any goods and securities bailed to him for a general balance of account.
8. Right of set off and right of appropriation.
9. Right to claim incidental charges and interest as per rules and regulations of the bank, as communicated to the customer at the time of opening the account.

### **Liability of a Banker**

By opening a current account of a customer, the banker becomes liable to his debtor to the extent of the amount so received in the said account and undertakes to honour the cheques drawn by the customer so long as he holds sufficient funds to the customer's credit. If a banker, without justification, fails to honour his customer's cheques, he is liable to compensate the drawer for any loss or damage suffered by him. But the payee or holder of the cheque has no cause of action against the banker as the obligation to honour a cheque is only towards the drawer.

The banker must also maintain proper and accurate accounts of credits and debits. He must honour a cheque presented in due course. But in the following circumstances, he must refuse to honour a cheque and in some others he may do so.

### **When Banker must Refuse Payment**

In the following cases the authority of the banker to honour customer's cheque comes to an end, he must refuse to honour cheques issued by the customer:

- (a) When a customer countermands payment i.e., where or when a customer, after issuing a cheque issues instructions not to honour it, the banker must not pay it.
- (b) When the banker receives notice of customer's death.
- (c) When customer has been adjudged an insolvent.
- (d) When the banker receives notice of customer's insanity.
- (e) When an order (e.g., Garnishee Order) of the Court, prohibits payment.
- (f) When the customer has given notice of assignment of the credit balance of his account.
- (g) When the holder's title is defective and the banker comes to know of it.
- (h) When the customer has given notice for closing his account.

### **When Banker may Refuse Payment**

In the following cases the banker may refuse to pay a customer's cheque:

- (a) When the cheque is post-dated.
- (b) When the banker has no sufficient funds of the drawer with him and there is no communication between the bank and the customer to honour the cheque.
- (c) When the cheque is of doubtful legality.
- (d) When the cheque is not duly presented, e.g., it is presented after banking hours.
- (e) When the cheque on the face of it is irregular, ambiguous or otherwise materially altered.
- (f) When the cheque is presented at a branch where the customer has no account.

- (g) When some persons have joint account and the cheque is not signed jointly by all or by the survivors of them.
- (h) When the cheque has been allowed to become stale, i.e., it has not been presented within six months of the date mentioned on it.

### Protection of Paying Banker (Sections 10, 85 and 128)

Section 85 lays down that where a cheque payable to order purports to be endorsed by or on behalf of the payee the banker is discharged by payment in due course. He can debit the account of the customer with the amount even though the endorsement turns out subsequently to have been forged, or the agent of the payee without authority endorsed it on behalf of the payee. It would be seen that the payee includes endorsee. This protection is granted because a banker cannot be expected to know the signatures of all the persons in the world. He is only bound to know the signatures of his own customers.

Therefore, the forgery of drawer's signature will not ordinarily protect the banker but even in this case, the banker may debit the account of the customer, if it can show that the forgery was intimately connected with the negligence of the customer and was the proximate cause of loss.

In the case of bearer cheques, the rule is that once a bearer cheque, always a bearer cheque. Where, therefore, a cheque originally expressed by the drawer himself to be payable to bearer, the banker may ignore any endorsement on the cheque. He will be discharged by payment in due course. But a cheque which becomes bearer by a subsequent endorsement in blank is not covered by this Section. A banker is discharged from liability on a crossed cheque if he makes payment in due course.

### Payment in due Course (Section 10)

Any person liable to make payment under a negotiable instrument, must make the payment of the amount due thereunder in due course in order to obtain a valid discharge against the holder.

A payment in due course means a payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof.

A payment will be a payment in due course if:

- (a) it is in accordance with the apparent tenor of the instrument, i.e., according to what appears on the face of the instrument to be the intention of the parties;
- (b) it is made in good faith and without negligence, and under circumstances which do not afford a ground for believing that the person to whom it is made is not entitled to receive the amount;
- (c) it is made to the person in possession of the instrument who is entitled as holder to receive payment;
- (d) payment is made under circumstances which do not afford a reasonable ground believing that he is not entitled to receive payment of the amount mentioned in the instrument; and
- (e) payment is made in money and money only.

Under Sections 10 and 128, a paying banker making payment in due course is protected.

### Collecting Banker

Collecting Banker is one who collects the proceeds of a cheque for a customer. Although a banker collects the proceeds of a cheque for a customer purely as a matter of service, yet the Negotiable Instruments Act, 1881 indirectly imposes statutory obligation, statutory in nature. This is evident from Section 126 of the Act which provides that a cheque bearing a "general crossing" shall not be paid to anyone other than banker and a cheque which is "specially crossed" shall not be paid to a person other than the banker to whom it is crossed. Thus, a paying banker must pay a generally crossed cheque only to a banker thereby meaning that it should be collected by another banker. While so collecting the cheques for a customer, it is quite possible that the banker collects for a customer, proceeds of a cheque to which the customer had no title in fact. In such cases, the true owner may sue the collecting banker for "conversion". At the same time, it cannot be expected of a banker to know or to ensure that all the signatures

appearing in endorsements on the reverse of the cheque are genuine. The banker is expected to be conversant only with the signatures of his customer. A customer to whom a cheque has been endorsed, would request his banker to collect a cheque. In the event of the endorser's signature being proved to be forged at later date, the banker who collected the proceeds should not be held liable for the simple reason that he has merely collected the proceeds of a cheque. Section 131 of the Negotiable Instruments Act affords statutory protection in such a case where the customer's title to the cheque which the banker has collected has been questioned. It reads as follows:

**"A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason of only having received such payment."**

**Explanation:** A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof."

The Amendment Act, 2002 has added a new explanation to Section 131 which provides that it shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the *prima facie* genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care. (*Explanation II*)

The requisites of claiming protection under Section 131 are as follows:

- (i) The collecting banker should have acted in good faith and without negligence. An act is done in good faith when it is done honestly. The plea of good faith can be rebutted on the ground of recklessness indicative of want of proper care and attention. Therefore, much depends upon the facts of the case.  
The burden of proving that the cheque was collected in good faith and without negligence is upon the banker claiming protection. Failure to verify the regularity of endorsements, collecting a cheque payable to the account of the company to the credit of the director, etc. are examples of negligence.
- (ii) The banker should have collected a crossed cheque, i.e., the cheque should have been crossed before it came to him for collection.
- (iii) The proceeds should have been collected for a customer, i.e., a person who has an account with him.
- (iv) That the collecting banker has only acted as an agent of the customer. If he had become the holder for value, the protection available under Section 131 is forfeited—Where for instance, the banker allows the customer to withdraw the amount of the cheque before the cheque is collected or where the cheque has been accepted in specific reduction of an overdraft, the banker is deemed to have become the holder for value and the protection is lost. But the explanation to Section 131 says that the mere crediting of the amount to the account does not imply that the banker has become a holder for value because due to accounting conveniences the banker may credit the account of the cheque to the customer's account even before proceeds thereof are realised.

### Overdue, Stale or Out-of-date Cheques

A cheque is overdue or becomes statute-barred after three years from its due date of issue. A holder cannot sue on the cheque after that time. Apart from this provision, the holder of a cheque is required to present it for payment within a reasonable time, as a cheque is not meant for indefinite circulation. In India, a cheque, which has been in circulation for more than six months, is regarded by bankers as stale. If, as a result of any delay in presenting a cheque, the drawer suffers any loss, as by the failure of the bank, the drawer is discharged from liability to the holder to the extent of the damage.

### Liability of Endorser

In order to charge an endorser, it is necessary to present the cheque for payment within a reasonable time of its delivery by such endorser. 'A' endorses and delivers a cheque to B, and B keeps it for an unreasonable length of time, and then endorses and delivers it to C. C presents it for payment within a reasonable time after its receipt by him, and it is dishonoured. C can enforce payment against B but not against A, as *qua* A, the cheque has become stale.

## Rights of Holder against Banker

A banker is liable to his customer for wrongful dishonour of his cheque but it is not liable to the payee or holder of the cheque. The holder has no right to enforce payment from the banker except in two cases, namely, (i) where the holder does not present the cheque within a reasonable time after issue, and as a result the drawer suffers damage by the failure of the banker in liquidation proceedings; and (ii) where a banker pays a crossed cheque by mistake over the counter, he is liable to the owner for any loss occasioned by it.

### Crossing of Cheques

A cheque is either "open" or "crossed". An open cheque can be presented by the payee to the paying banker and is paid over the counter. A crossed cheque cannot be paid across the counter but must be collected through a banker.

A crossing is a direction to the paying banker to pay the money generally to a banker or to a particular banker, and not to pay otherwise. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque. Crossing is a direction to the paying banker that the cheque should be paid only to a banker or a specified banker. To restrain negotiability, addition of words "Not Negotiable" or "Account Payee Only" is necessary. A crossed bearer cheque can be negotiated by delivery and crossed order cheque by endorsement and delivery. Crossing affords security and protection to the holder of the cheque.

### Modes of Crossing (Sections 123-131A)

There are two types of crossing which may be used on cheque, namely: (i) General, and (ii) Special. To these may be added another type, i.e. Restrictive crossing.

It is general crossing where a cheque bears across its face an addition of two parallel transverse lines and/ or the addition of the words "and Co." between them, or addition of "not negotiable". As stated earlier, where a cheque is crossed generally, the paying banker will pay to any banker. Two transverse parallel lines are essential for a general crossing (Sections 123-126).

In case of general crossing, the holder or payee cannot get the payment over the counter of the bank but through a bank only. The addition of the words "and Co." do not have any significance but the addition of the words "not negotiable" restrict the negotiability of the cheque and in case of transfer, the transferee will not give a better title than that of a transferor.

Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable" that addition constitutes a crossing and the cheque is crossed specially and to that banker. The paying banker will pay only to the banker whose name appears across the cheque, or to his collecting agent. Parallel transverse lines are not essential but the name of the banker is the insignia of a special crossing.

In case of special crossing, the paying banker is to honour the cheque only when it is prescribed through the bank mentioned in the crossing or its agent bank.

*Account Payee's Crossing:* Such crossing does, in practice, restrict negotiability of a cheque. It warns the collecting banker that the proceeds are to be credited only to the account of the payee, or the party named, or his agent. If the collecting banker allows the proceeds of a cheque bearing such crossing to be credited to any other account, he will be guilty of negligence and will not be entitled to the protection given to collecting banker under Section 131. Such crossing does not affect the paying banker, who is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

### Not Negotiable Crossing

A cheque may be crossed not negotiable by writing across the face of the cheque the words "Not Negotiable" within two transverse parallel lines in the case of a general crossing or alongwith the name of a banker in the case of a special crossing. Section 130 of the Negotiable Instruments Act provides "A person taking a cheque crossed generally

or specially bearing in either case with the words "not negotiable" shall not have and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had". The crossing of cheque "not negotiable" does not mean that it is non-transferable. It only deprives the instrument of the incident of negotiability. Normally speaking, the essential feature of a negotiable instrument as opposed to chattels is that a person who takes the instrument in good faith, without negligence, for value, before maturity and without knowledge of the defect in the title of the transferor, gets a good title to the instrument. In other words, he is called a holder in due course who acquires an indisputable title to the cheque. (When the instrument passes through a holder-in-due course, it is purged of all defects and the subsequent holders also get good title). It is exactly this important feature which is taken away by crossing the cheque "not negotiable". In other words, a cheque crossed "not negotiable" is like any other chattel and therefore the transferee gets same title to the cheque which his transferor had. That is to say that the transferee cannot claim the rights of a holder-in-due-course. So long as the title of the transferors is good, the title of the transferees is also good but if there is a taint in the title to the cheque of one of the endorsers, then all the subsequent transferees' title also become tainted with the same defect they cannot claim to be holders-in-due-course.

The object of this Section is to afford protection to the drawer or holder of a cheque who is desirous of transmitting it to another person, as much protection as can reasonably be afforded to him against dishonestly or actual miscarriage in the course of transit. For example, a cheque payable to bearer is crossed generally and is marked "not negotiable". It is lost or stolen and comes into the possession of X who takes it in good faith and gives value for it, X collects the cheque through his bank and paying banker also pays. In this case, both the paying and the collecting bankers are protected under Sections 128 and 131 respectively. But X cannot claim that he is a holder-in-due course which he could have under the normal circumstances claimed. The reason is that cheque is crossed "not negotiable" and hence the true owner's (holder's) right supercedes the rights of the holder-in-due-course. Since X obtained the cheque from a person who had no title to the cheque (i.e. from one whose title was defective) X can claim no better title solely because the cheque was crossed "not negotiable" and not for any other reason. Thus "not negotiable" crossing not only protects the rights of the true owner of the cheque but also serves as a warning to the endorsees' to enquire thoroughly before taking the cheque as they may have to be answerable to the true owner thereof if the endorser's title is found to be defective.

"Not negotiable" restricts the negotiability of the cheque and in case of transfer, the transferee will not get a better title than that of a transferor.

If the cheque becomes "not negotiable" it lacks negotiability. A cheque crossed specially or generally bearing the words "not negotiable", lacks negotiability and therefore is not a negotiable instrument in the true sense. It does not restrict transferability but restricts negotiability only.

Specimen of a general crossing

\_\_\_\_\_  
\_\_\_\_\_  
  
\_\_\_\_\_  
& Co.  
  
\_\_\_\_\_  
  
Not Negotiable

Specimen of a special crossing

Model Bank  
\_\_\_\_\_  
Model Bank  
\_\_\_\_\_  
Not Negotiable  
\_\_\_\_\_  
Model Bank  
  
Model Bank  
Not Negotiable

## Maturity

Cheques are always payable on demand but other instruments like bills, notes, etc. may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called its maturity. According to Section 22 of the Act, "the maturity of a promissory note or a bill of exchange is the date at which it falls due". According to Section 21 a promissory note or bill of exchange payable "at sight" or "on presentment" is payable on demand. It is due for payment as soon as it is issued. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange payable "after date" or "after sight" or at a certain period after the happening of an event which is certain to happen.

Maturity is the date on which the payment of an instrument falls due. Every instrument payable at a specified period after date or after sight is entitled to three days of grace. Such a bill or note matures or falls due on the last day of the grace period, and must be presented for payment on that day and if dishonoured, suit can be instituted on the next day after maturity. If an instrument is payable by instalments, each instalment is entitled to three days of grace. No days of grace are allowed for cheques, as they are payable on demand.

Where a note or bill is expressed to be payable on the expiry of specified number of months after sight, or after date, the period of payment terminates on the day of the month which corresponds with the date of instrument, or with the date of acceptance if the bill be accepted or presented for sight, or noted or protested for non-acceptance. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

### Illustrations

- (i) A negotiable instrument dated 31st January, 2001, is made payable at one months after date. The instrument is at maturity on the third day after the 28th February, 2001, i.e. on 3rd March, 2001.
- (ii) A negotiable instrument dated 30th August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.
- (iii) A negotiable instrument dated the 31st August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

If the day of maturity falls on a public holiday, the instrument is payable on the preceding business day. Thus, if a bill is at maturity on a Sunday. It will be deemed due on Saturday and not on Monday.

The ascertainment of the date of maturity becomes important because all these instruments must be presented for payment on the last day of grace and their payment cannot be demanded before that date. Where an instrument is payable by instalments, it must be presented for payment on the third day after the day fixed for the payment of each instalment.

## Holder

According to Section 8 of the Act a person is a holder of a negotiable instrument who is entitled in his own name to the possession of the instrument, and (ii) to recover or receive its amount from the parties thereto. It is not every person in possession of the instrument who is called a holder. To be a holder, the person must be named in the instrument as the payee, or the endorsee, or he must be the bearer thereof. A person who has obtained possession of an instrument by theft, or under a forged endorsement, is not a holder, as he is not entitled to recover the instrument. The holder implies de jure (holder in law) holder and not de facto (holder in fact) holder. An agent holding an instrument for his principal is not a holder although he may receive its payment.

## Holder in Due Course

Section 9 states that a holder in due course is (i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or (ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In order to be a holder in due course, a person must satisfy the following conditions:

- (i) He must be the holder of the instrument.
- (ii) He should have obtained the instrument for value or consideration.
- (iii) He must have obtained the negotiable instrument before maturity.
- (iv) The instrument should be complete and regular on the face of it.
- (v) The holder should take the instrument in good faith.

A holder in due course is in a privileged position. He is not only himself protected against all defects of the persons from whom he received the instrument as current coin, but also serves as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties, although, as a matter of fact, no consideration was paid by some of the previous parties to the instrument or there was a defect of title in the party from whom he took it. Once an instrument passes through the hands of a holder in due course, it is purged of all defects. It is like current coin. Whoever takes it can recover the amount from all parties previous to such holder.

## Capacity of Parties

Capacity to incur liability as a party to a negotiable instrument is co-extensive with capacity to contract. According to Section 26, every person capable of contracting according to law to which he is subject, may bind himself and be bound by making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Negatively, minors, lunatics, idiots, drunken person and persons otherwise disqualified by their personal law, do not incur any liability as parties to negotiable instruments. But incapacity of one or more of the parties to a negotiable instrument in no way, diminishes the abilities and the liabilities of the competent parties. Where a minor is the endorser or payee of an instrument which has been endorsed all the parties accepting the minor are liable in the event of its dishonour.

## Liability of Parties

The provisions regarding the liability of parties to negotiable instruments are laid down in Sections 30 to 32 and 35 to 42 of the Negotiable Instruments Act. These provisions are as follows:

### 1. Liability of Drawer (Section 30)

The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to or received by the drawer.

The nature of drawer's liability is that by drawing a bill, he undertakes that (i) on due presentation, it shall be accepted and paid according to its tenor, and (ii) in case of dishonour, he will compensate the holder or any endorser, provided notice of dishonour has been duly given. However, in case of accommodation bill no notice of dishonour to the drawer is required.

The liability of a drawer of a bill of exchange is secondary and arises only on default of the drawee, who is primarily liable to make payment of the negotiable instrument.

### 2. Liability of the Drawee of Cheque (Section 31)

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and, or in default of such payment, he shall compensate the drawer for any loss or damage caused by such default.

As a cheque is a bill of exchange, drawn on a specified banker, the drawee of a cheque must always be a banker. The banker, therefore, is bound to pay the cheque of the drawer, i.e., customer, if the following conditions are satisfied:

- (i) The banker has sufficient funds to the credit of customer's account.
- (ii) The funds are properly applicable to the payment of such cheque, e.g., the funds are not under any kind of lien etc.
- (iii) The cheque is duly required to be paid, during banking hours and on or after the date on which it is made payable.

If the banker is unjustified in refusing to honour the cheque of its customer, it shall be liable for damages.

### **3. Liability of "Maker" of Note and "Acceptor" of Bill (Section 32)**

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand.

It follows that the liability of the acceptor of a bill corresponds to that of the maker of a note and is absolute and unconditional but the liability under this Section is subject to a contract to the contrary (e.g., as in the case of accommodation bills) and may be excluded or modified by a collateral agreement. Further, the payment must be made to the party named in the instrument and not to any-one else, and it must be made at maturity and not before.

### **4. Liability of endorser (Section 35)**

Every endorser incurs liability to the parties that are subsequent to him. Whoever endorses and delivers a negotiable instrument before maturity is bound thereby to every subsequent holder in case of dishonour of the instrument by the drawee, acceptor or maker, to compensate such holder of any loss or damage caused to him by such dishonour provided (i) there is no contract to the contrary; (ii) he (endorser) has not expressly excluded, limited or made conditional his own liability; and (iii) due notice of dishonour has been given to, or received by, such endorser. Every endorser after dishonour, is liable upon the instrument as if it is payable on demand.

He is bound by his endorsement notwithstanding any previous alteration of the instrument. (Section 88)

### **5. Liability of Prior Parties (Section 36)**

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Prior parties may include the maker or drawer, the acceptor and all the intervening endorsers to a negotiable instrument. The liability of the prior parties to a holder in due course is joint and several. The holder in due course may hold any or all prior parties liable for the amount of the dishonoured instrument.

### **6. Liability inter se**

Various parties to a negotiable instrument who are liable thereon stand on a different footing with respect to the nature of liability of each one of them.

### **7. Liability of Acceptor of Forged Endorsement (Section 41)**

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged, if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

### **8. Acceptor's Liability on a Bill drawn in a Fictitious Name**

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

## Negotiation (Section 14)

A negotiable instrument may be transferred by negotiation or assignment. Negotiation is the transfer of an instrument (a note, bill or cheque) for one person to another in such a manner as to convey title and to constitute the transferee the holder thereof. When a negotiable instrument is transferred by negotiation, the rights of the transferee may rise higher than those of the transferor, depending upon the circumstances attending the negotiation. When the transfer is made by assignment, the assignee has only those rights which the assignor possessed. In case of assignment, there is a transfer of ownership by means of a written and registered document.

## Negotiability and Assignability Distinguished

A transfer by negotiation differs from transfer by assignment in the following respects:

- Negotiation requires mere delivery of a bearer instrument and endorsement and delivery of an order instrument to effectuate a transfer. Assignment requires a written document signed by the transferor.
- Notice of transfer of debt (actionable claim) must be given by the assignee to the debtor in order to complete his title; no such notice is necessary in a transfer by negotiation.
- On assignment, the transferee of an actionable claim takes it subject to all the defects in the title of, and subject to all the equities and defences available against the assignor, even though he took the assignment for value and in good faith. In case of negotiation the transferee, as holder-in-due course, takes the instrument free from any defects in the title of the transferor.

## Importance of Delivery

Negotiation is effected by mere delivery of a bearer instrument and by endorsement and delivery of an order instrument. This shows that "delivery" is essential in negotiable instruments. Section 46 expressly provides that making acceptance or endorsement of negotiable instrument is not complete until delivery, actual or constructive, of the instrument. Delivery made voluntarily with the intention of passing property in the instrument to the person to whom it is given is essential.

## Negotiation by Mere Delivery

A bill or cheque payable to bearer is negotiated by mere delivery of the instrument. An instrument is payable to bearer:

- Where it is made so payable, or
- Where it is originally made payable to order but the only or the last endorsement is in blank.
- Where the payee is a fictitious or a non-existing person.

These instruments do not require signature of the transferor. The person who takes them is a holder, and can sue in his own name on them. Where a bearer negotiates an instrument by mere delivery, and does not put his signature thereon, he is not liable to any party to the instrument in case the instrument is dishonoured, as he has not lent his credit to it. His obligations are only towards his immediate transferee and to no other holders.

A cheque, originally drawn payable to bearer remains bearer, even though it is subsequently endorsed in full. The rule is once a bearer cheque always a bearer cheque.

## Negotiation by Endorsement and Delivery

An instrument payable to a specified person or to the order of a specified person or to a specified person or order is an instrument payable to order. Such an instrument can be negotiated only by endorsement and delivery. Unless the holder signs his endorsement on the instrument, the transferee does not become a holder. Where an instrument payable to order is delivered without endorsement, it is merely assigned and not negotiated and the holder thereof is not entitled to the rights of a holder in due course, and he cannot negotiate it to a third person.

## Endorsement (Sections 15 and 16)

Where the maker or holder of a negotiable instrument signs the same otherwise than as such maker for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto (called Allonge), or so, signs for the same purpose, a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same (Section 15), the person to whom the instrument is endorsed is called the endorsee.

In other words, 'endorsement' means and involves the writing of something on the back of an instrument for the purpose of transferring the right, title and interest therein to some other person.

### Classes of endorsement

An endorsement may be (a) Blank or General, (b) Special or Full, (c) Restrictive, or (d) Partial, and (e) Conditional or Qualified.

- (a) Blank or General: An endorsement is to be blank or general where the endorser merely writes his signature on the back of the instrument, and the instrument so endorsed becomes payable to bearer, even though originally it was payable to order. Thus, where bill is payable to "Mohan or order", and he writes on its back "Mohan", it is an endorsement in blank by Mohan and the property in the bill can pass by mere delivery, as long as the endorsement continues to be a blank. But a holder of an instrument endorsed in blank may convert the endorsement in blank into an endorsement in full, by writing above the endorser's signature, a direction to pay the instrument to another person or his order.
- (b) Special or Full: If the endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be special or in full. A bill made payable to Mohan or Mohan or order, and endorsed "pay to the order of Sohan" would be specially endorsed and Sohan endorses it further. A blank endorsement can be turned into a special one by the addition of an order making the bill payable to the transferee.
- (c) Restrictive: An endorsement is restrictive which prohibits or restricts the further negotiation of an instrument. Examples of restrictive endorsement: "Pay A only" or "Pay A for my use" or "Pay A on account of B" or "Pay A or order for collection".
- (d) Partial: An endorsement partial is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. A partial endorsement does not operate as negotiation of the instrument. A holds a bill for Rs. 1,000 and endorses it as "Pay B or order Rs. 500". The endorsement is partial and invalid.
- (e) Conditional or qualified: An endorsement is conditional or qualified which limits or negatives the liability of the endorser. An endorser may limit his liability in any of the following ways:
  - (i) By sans recourse endorsement, i.e. by making it clear that he does not incur the liability of an endorser to the endorsee or subsequent holders and they should not look to him in case of dishonour of instrument. The endorser excludes his liability by adding the words "sans recourse" or "without recourse", e.g., "pay A or order sans recourse".
  - (ii) By making his liability depending upon happening of a specified event which may never happen, e.g., the holder of a bill may endorse it thus: "Pay A or order on his marrying B". In such a case, the endorser will not be liable until A marries B.

It is pertinent to refer to Section 52 of the Negotiable Instruments Act, 1881 here. It reads "The endorser of a negotiable instrument may, by express words in the endorsement exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen".

### Negotiation Back

Where an endorser negotiates an instrument and again becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsee are then liable to him. The rule prevents a circuit of action. For example, A, the holder of a bill endorses it to B, B endorses to C, and C to D, and endorses it again to A. A, being a holder in due course of the bill by second endorsement by D, can recover the amount thereof from B, C, or D

and himself being a prior party is liable to all of them. Therefore, A having been relegated by the second endorsement to his original position, cannot sue B, C and D.

*Where an endorser so excludes his liability and afterwards becomes the holder of the instrument, all the intermediate endorsers are liable to him.* "the italicised portion of the above Section is important".

### Illustration

A is the payee of a negotiable instrument. He endorses the instrument 'sans recourse' to B, B endorses to C, C to D, and D again endorses it to A. In this case, A is not only reinstated in his former rights but has the right of an endorsee against B, C and D.

## Negotiation of Lost Instrument or that Obtained by Unlawful Means

When a negotiable instrument has been lost or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee, who claims through the person who found or obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor, or holder from any party prior to such holder unless such possessor or endorsee is, or some person through whom he claims was, a holder in due course.

### Forged Endorsement

The case of a forged endorsement is worth special notice. If an instrument is endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee obtains title only through his endorsement. Thus, if an instrument be negotiated by means of a forged endorsement, the endorsee acquires no title even though he be a purchaser for value and in good faith, for the endorsement is a nullity. Forgery conveys no title. *But where the instrument is a bearer instrument or has been endorsed in blank, it can be negotiated by mere delivery, and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to the instrument.* For example, a bill is endorsed, "Pay A or order". A endorses it in blank, and it comes into the hands of B, who simply delivers it to C, C forges B's endorsement and transfer it to D. Here, D, as the holder does not derive his title through the forged endorsement of B, but through the genuine endorsement of A and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

### Acceptance of a Bill of Exchange

The drawee of a bill of exchange, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights against him. The drawee becomes liable only after he accepts the bill. The acceptor has to write the word 'accepted' on the bill and sign his name below it. Thus, it is the acceptor who is primarily liable on a bill.

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Thus, when the drawee writes across the face of the bill the word "accepted" and signs his name underneath he becomes the acceptor of the bill.

An acceptance may be either general or qualified. A general acceptance is absolute and as a rule, an acceptance has to be general. Where an acceptance is made subject to some condition or qualification, thereby varying the effect of the bill, it is a qualified acceptance. The holder of the bill may either refuse to take a qualified acceptance or non-acquiescence in it. Where he refuses to take it, he can treat the bill as dishonoured by non-acceptance, and sue the drawer accordingly.

### Acceptance for Honour

When a bill has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder, by writing on the bill, accept the same for the honour of any party thereto. The stranger so accepting, will declare under his hand that he accepts the protested bill for the honour of the drawer or any particular endorser whom he names.

The acceptor for honour is liable to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has been noted and protested for non-payment. Where a bill has been protested for non-payment after having been duly accepted, any person may intervene and pay it supra protest for the honour of any party liable on the bill. When a bill is paid *supra protest*, it ceases to be negotiable. The stranger, on paying for honour, acquires all the right of holder for whom he pays.

### Presentment for Acceptance

It is only bills of exchange that require presentment for acceptance and even these of certain kinds only. Bills payable on demand or on a fixed date need not be presented. Thus, a bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. But the following bills must be presented for acceptance otherwise, the parties to the bill will not be liable on it:

- (a) A bill payable after sight. Presentment is necessary in order to fix maturity of the bills; and
- (b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

Section 15 provides that the presentment for acceptance must be made to the drawee or his duly authorised agent. If the drawee is dead, the bill should be presented to his legal representative, or if he has been declared an insolvent, to the official receiver or assigner.

The following are the persons to whom a bill of exchange should be presented:

- (i) The drawee or his duly authorised agent.
- (ii) If there are many drawees, bill must be presented to all of them.
- (iii) The legal representatives of the drawee if drawee is dead.
- (iv) The official receiver or assignee of insolvent drawee.
- (v) To a drawee in case of need, if there is any. This is necessary when the original drawee refuses to accept the bill.
- (vi) The acceptor for honour. In case the bill is not accepted and is noted or protested for non-acceptance, the bill may be accepted by the acceptor for honour. He is a person who comes forward to accept the bill when it is dishonoured by non-acceptance.

The presentment must be made before maturity, within a reasonable time after it is drawn, or within the stipulated period, if any, on a business day within business hours and at the place of business or residence of the drawee. The presentment must be made by exhibiting the bill to the drawee; mere notice of its existence in the possession of holder will not be sufficient.

When presentment is compulsory and the holder fails to present for acceptance, the drawer and all the endorsers are discharged from liability to him.

### Presentment for Acceptance when Excused

Compulsory presentment for acceptance is excused and the bill may be treated as dishonoured in the following cases:

- (a) Where the drawee cannot be found after reasonable search.
- (b) Where drawee is a fictitious person or one incapable of contracting.
- (c) Where although the presentment is irregular, acceptance has been refused on some other ground.

### Presentment for Payment

Section 64 lays down the general rule as to presentment of negotiable instruments for payment. It says all notes, bills and cheques must be presented for payment thereof respectively by or on behalf of the holder during the usual hours of business and of the maker or acceptor, and if at banker's within banking hours. [Section 64(1)]

As mentioned earlier, the definition of cheque has been broadened to include the electronic image of a truncated cheque and a cheque in the electronic form. Thus, the section has also been suitably amended to provide rules as to presentment of truncated cheque. The amendment, despite recognising electronic image of a truncated cheque, has made provision for the drawee bank to call for the truncated cheque in original if it is not satisfied about the instrument.

Section 64(2) stipulates, where an electronic image of a truncated cheque is presented for payment, the drawee bank is entitled to demand any further information regarding the truncated cheque from the bank holding the truncated cheque in case of any reasonable suspicion about the genuineness of the apparent tenor of instrument, and if the suspicion is that of any fraud, forgery, tampering or destruction of the instrument, it is entitled to further demand the presentment of the truncated cheque itself for verification:

Provided that the truncated cheque so demanded by the drawee bank shall be retained by it, if the payment is made accordingly.

### Presentment for Payment when Excused

No presentment is necessary and the instrument may be treated as dishonoured in the following cases:

- (a) Where the maker, drawer or acceptor actively does something so as to intentionally obstruct the presentment of the instrument, e.g., deprives the holder of the instrument and keeps it after maturity.
- (b) Where his business place is closed on the due date.
- (c) Where no person is present to make payment at the place specified for payment.
- (d) Where he cannot, after due search be found. (Section 61)
- (e) Where there is a promise to pay notwithstanding non-presentment.
- (f) Where the presentment is express or impliedly waived by the party entitled to presentment.
- (g) Where the drawer could not possibly have suffered any damage by non-presentment.
- (h) Where the drawer is a fictitious person, or one incompetent to contract.
- (i) Where the drawer and the drawee are the same person.
- (j) Where the bill is dishonoured by non-acceptance.
- (k) Where presentment has become impossible, e.g., the declaration of war between the countries of the holder and drawee.
- (l) Where though the presentment is irregular, acceptance has been refused on some other grounds.

### Dishonour by Non-Acceptance

Section 91 provides that a bill is said to be dishonoured by non-acceptance:

- (a) When the drawee does not accept it within 48 hours from the time of presentment for acceptance.
- (b) When presentment for acceptance is excused and the bill remains unaccepted.
- (c) When the drawee is incompetent to contract.
- (d) When the drawee is a fictitious person or after reasonable search can not be found.
- (e) Where the acceptance is a qualified one.

### Dishonour by Non-payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in payment upon being duly required to pay the same. Also, a negotiable instrument is dishonoured by non-payment when presentment for payment is excused and the instrument when overdue remains unpaid.

If the bill is dishonoured either by non-acceptance or by non-payment, the drawer and all the endorsers of the bill are liable to the holder, provided he gives notice of such dishonour. The drawee is liable only when there is dishonour by non-payment.

### Notice of Dishonour (Sections 91-98 and Sections 105-107)

When a negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder or some party liable thereon must give notice of dishonour to all other parties whom he seeks to make liable. Each party receiving notice of dishonour must in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time after he has received it. The object of giving notice is not to demand payment but to whom the party notified of his liability and in case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured the instrument issued by him. Notice of dishonour is so necessary that an omission to give it discharges all parties other than the maker or acceptor. These parties are discharged not only on the bill or note, but also in respect of the original consideration.

Notice may be oral or in writing, but it must be actual formal notice. It must be given within a reasonable time of dishonour.

#### Notice of Dishonour Unnecessary

No notice of dishonour is necessary:

- (a) When it is dispensed with or waived by the party entitled thereto, e.g., where an endorser writes on the instrument such words as "notice of dishonour waived",
- (b) When the drawer has countermanded payment.
- (c) When the party charged would not suffer damage for want of notice.
- (d) When the party entitled to notice cannot after due search be found.
- (e) When the omission to give notice is caused by unavoidable circumstances, e.g., death or dangerous illness of the holder.
- (f) Where the acceptor is also a drawer, e.g., where a firm draws on its branch.
- (g) Where the promissory note is not negotiable. Such a note cannot be endorsed.
- (h) Where the party entitled to notice promises to pay unconditionally.

### NOTING AND PROTEST (SECTIONS 99-104 A)

#### Noting

Where a note or bill is dishonoured, the holder is entitled after giving due notice of dishonour, to sue the drawer and the endorsers. Section 99 provides a convenient method of authenticating the fact of dishonour by means of "Noting". Where a bill or note is dishonoured, the holder may, if he so desires, cause such dishonour to be noted by a notary public on the instrument, or on a paper attached thereto or partly on each. The noting or minute must be recorded by the notary public within a reasonable time after dishonour and must contain the fact of dishonour, the date of dishonour, the reason, if any, assigned for such dishonour if the instrument has not been expressly dishonoured the reasons why the holder treats it dishonoured and notary's charges.

#### Protest

The protest is the formal notarial certificate attesting the dishonour of the bill, and based upon the noting which has been effected on the dishonour of the bill. After the noting has been made, the formal protest is drawn up by the notary and when it is drawn up it relates back to the date of noting.

Where the acceptor of a bill has become insolvent, or has suspended payment, or his credit has been publicly impeached, before the maturity of the bill, the holder may have the bill protested for better security. The notary

public demands better security and on its refusal makes a protest known as "protest for better security".

Foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Foreign promissory notes need not be so protested. Where a bill is required by law to be protested, then instead of a notice of dishonour, notice of protest must be given by the notary public.

A protest to be valid must contain on the instrument itself or a literal transcript thereof, the names of the parties for and against whom protest is made, the fact and reasons for dishonour together with the place and time of dishonour and the signature of the notary public. Protest affords an authentic evidence of dishonour to the drawer and the endorsee.

## Discharge

The discharge in relation to negotiable instrument may be either (i) discharge of the instrument or (ii) discharge of one or more parties to the instrument from liability.

### Discharge of the Instrument

A negotiable instrument is discharged:

- (a) by payment in due course;
- (b) when the principal debtor becomes the holder;
- (c) by an act that would discharge simple contract;
- (d) by renunciation; and
- (e) by cancellation.

### Discharge of a Party or Parties

When any particular party or parties are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. For example, the non-presentment of a bill on the due date discharges the endorsers from their liability, but the acceptor remains liable on it.

A party may be discharged in the following ways :

- (a) By cancellation by the holder of the name of any party to it with the intention of discharging him.
- (b) By release, when the holder releases any party to the instrument
- (c) Discharge of secondary parties, i.e., endorsers.
- (d) By the operation of the law, i.e., by insolvency of the debtor.
- (e) By allowing drawee more than 48 hours to accept the bill, all previous parties are discharged.
- (f) By non-presentment of cheque promptly the drawer is discharged.
- (g) By taking qualified acceptance, all the previous parties are discharged.
- (h) By material alteration.

### Material Alteration (Section 87)

An alteration is material which in any way alters the operation of the instrument and the liabilities of the parties thereto. Therefore, any change in an instrument which causes it to speak a different language in legal effect from that which it originally spoke, or which changes legal character of the instrument is a material alteration.

A material alteration renders the instrument void, but it affects only those persons who have already become parties at the date of the alteration. Those who take the altered instrument cannot complain. Section 88 provides that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement notwithstanding any previous alteration of the instrument.

Examples of material alteration are :

Alteration (i) of the date of the instrument (ii) of the sum payable, (iii) in the time of payment, (iv) of the place of payment, (v) of the rate of interest, (vi) by addition of a new party, (vii) tearing the instrument in a material part.

There is no material alteration and the instrument is not vitiated in the following cases:

(i) correction of a mistake, (ii) to carry out the common intention of the parties, (iii) an alteration made before the instrument is issued and made with the consent of the parties, (iv) crossing a cheque, (v) addition of the words "on demand" in an instrument where no time of payment is stated.

Section 89 affords protection to a person who pays an altered note bill or cheque. However, in order to be able to claim the protection, the following conditions must be fulfilled:

- (i) the alteration should not be apparent;
- (ii) the payment must be made in due course; and
- (iii) the payment must be by a person or banker liable to pay.

Section 89 has been amended to provide for the amendment in the definition of cheque so as to provide for electronic image of a truncated cheque. The section provides that any bank or a clearing house which receives a transmitted electronic image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same. Where there is any difference in apparent tenor of such electronic image and the truncated cheque, it shall be a material alteration. In such a case, it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image. If the bank fails to discharge this duty, the payment made by it shall not be regarded as good and it shall not be afforded protection.

### Retirement of a Bill under Rebate

An acceptor of a bill may make payment before maturity, and the bill is then said to be retired, but it is not discharged and must not be cancelled except by the acceptor when it comes into his hands. It is customary in such a case to make allowance of interest on the money to the acceptor for the remainder of the time which the bill has to run. The interest allowance is known as rebate.

### Hundis

Hundis are negotiable instruments written in an oriental language. They are sometimes bills of exchange and sometimes promissory notes, and are not covered under the Negotiable Instruments Act, 1881. Generally, they are governed by the customs and usages in the locality but if custom is silent on the point in dispute before the Court, this Act applies to the hundis. The term "hundi" was formerly applicable to native bills of exchange. The promissory notes were then called "teep". The hundis were in circulation in India even before the present Negotiable Instrument Act, 1881 came into operation. The usages attached to these hundis varied with the locality in which they were in circulation.

Generally understood, the term "hundi" includes all indigenous negotiable instruments whether they are bills of exchange or promissory notes. An instrument in order to be a hundi must be capable of being sued by the holder in his own name, and must by the custom of trade be transferred like cash by delivery. Obviously the customs relating to hundis were many. In certain parts of the country even oral acceptance was in vague.

The following types of hundis are worth mentioning :

#### 1. Shah Jog Hundi

"Shah" means a respectable and responsible person or a man of worth in the bazar. Shah Jog Hundi means a hundi which is payable only to a respectable holder, as opposed to a hundi payable to bearer. In other words the drawee before paying the same has to satisfy himself that the payee is a 'SHAH'.

## 2. *Jokhmi Hundi*

A "jokhmi" hundi is always drawn on or against goods shipped on the vessel mentioned in the hundi. It implies a condition that money will be paid only in the event of arrival of the goods against which the hundi is drawn. It is in the nature of policy of insurance. The difference, however, is that the money is paid before hand and is to be recovered if the ship arrives safely.

## 3. *Jawabee Hundi*

According to Macpherson, "A person desirous of making a remittance writes to the payee and delivers the letter to a banker, who either endorses it on to any of his correspondents near the payee's place of residence, or negotiates its transfer. On the arrival, the letter is forwarded to the payee, who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel of the drawer or the order." Therefore, this is a form of hundi which is used for remitting money from one place to another.

## 4. *Nam jog Hundi*

It is a hundi payable to the party named in the bill or his order. The name of the payee is specifically inserted in the hundi. It can also be negotiated like a bill of exchange. Its alteration into a Shah Jog hundi is a material alteration and renders it void.

## 5. *Darshani Hundi*

This is a hundi payable at sight. It is freely negotiable and the price is regulated by demand and supply. They are payable on demand and must be presented for payment within a reasonable time after they are received by the holder.

## 6. *Miadi Hundi*

This is otherwise called *muddati* hundi, that is, a hundi payable after a specified period of time. Usually money is advanced against these hundis by shroffs after deducting the advance for the period in advance. There are other forms of hundis also like.

*Dhani Jog Hundi* - A hundi which is payable to "dhani" i.e., the owner.

*Firman Jog Hundi* - which is payable to order if can be negotiated by endorsement and delivery.

## Presumptions of Law

A negotiable instrument is subject to certain presumptions. These have been recognised by the Negotiable Instruments Act under Sections 118 and 119 with a view to facilitate the business transactions. These are described below:

It shall be presumed that:

- (1) Every negotiable instrument was made or drawn for consideration irrespective of the consideration mentioned in the instrument or not.
- (2) Every negotiable instrument having a date was made on such date.
- (3) Every accepted bill of exchange was accepted within a reasonable time before its maturity.
- (4) Every negotiable instrument was transferred before its maturity.
- (5) The instruments were endorsed in the order in which they appear on it.
- (6) A lost or destroyed instrument was duly signed and stamped.
- (7) The holder of the instrument is a holder in due course.
- (8) In a suit upon an instrument which has been dishonoured, the Court shall presume the fact of dishonour, or proof of the protest.

However these legal presumptions are rebuttable by evidence to the contrary. The burden to prove to the contrary lies upon the defendant to the suit and not upon the plaintiff.

## Payment of Interest in case of dishonour

The Negotiable Instruments Act, 1881 was amended in the year 1988, revising the rate of interest as contained in Sections 80 and 117, from 6 per cent to 18 per cent per annum payable on negotiable instruments from the due date in case no rate of interest is specified, or payable to an endorser from the date of payment on a negotiable instrument on its dishonour with a view to discourage the withholding of payment on negotiable instruments on due dates.

## Penalties in case of dishonour of cheques

Chapter XVII of the Negotiable Instruments Act provides for penalties in case of dishonour of certain cheques for insufficiencies of funds in the accounts. Sections 138 to 147 deal with these aspects.

Chapter XVII has been amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002. The amendments have provided the drawer with more time to send notice, made the punishment for the offence more stringent, given power to court for condonation of delay in filing of complaint, excluded liability of government nominated directors, made provision for summary trial of cases under the Chapter and time bound disposal of cases, have relaxed the rules of evidence, and made the offences under the Act compoundable.

Further Chapter XVII amended by the Negotiable Instruments (Amendment) Act, 2015. The amendment focused on clarifying the jurisdiction related issues for filing cases for offence committed under section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015, facilitates filing of cases only in a court within whose local jurisdiction the bank branch of the payee, where the payee delivers the cheque for payment through his account, is situated, except in case of bearer cheques, which are presented to the branch of the drawee bank and in that case the local court of that branch would get jurisdiction. The Negotiable Instruments (Amendment) Act, 2015 provides for retrospective validation for the new scheme of determining the jurisdiction of a court to try a case under Section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015 also mandates centralisation of cases against the same drawer.

With a view to address the issue of undue delay in final resolution of cheque dishonour cases so as to provide relief to payees of dishonoured cheques and to discourage frivolous and unnecessary litigation, Parliament enacted the Negotiable Instruments (Amendment) Act, 2018 and notified by the Central Government on 1st September, 2018. The Amendments Act strengthen the credibility of cheques and help trade and commerce in general by allowing lending institutions, including banks, to continue to extend financing to the productive sectors of the economy. The Negotiable Instruments (Amendment) Act, 2018 inserted two new sections i.e. Section 143A dealing with Power to direct interim compensation and Section 148 dealing with Power of Appellate Court to order payment pending appeal against conviction.

## Dishonour of Cheque for Insufficiency, etc., of Funds in the Account

Section 138 of the Act provides that where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that 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 that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may be extended to two years', or with fine which may extend to twice the amount of the cheque, or with both.

Provided that nothing contained in this section shall apply unless—

- (a) the cheque has been presented to the bank within a period of six 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 fifteen days of the receipt of the said notice.

## Presumption in Favour of Holder

As per Section 139 of the Act, 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.

Once the execution of cheque is admitted, Section 139 creates a presumption that the holder of a cheque receives the cheque in discharge, in whole or in part, of any debt or other liability, *Basalingappa vs. Mudibassapa*, 2019 SCC OnLine SC 491.

## Defence which may not be Allowed in any Prosecution under Section 138

Section 140 states that it shall not be a defence in a prosecution for an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in section 138.

## Offences by Companies

According to Section 141(1) of the Act, if the person committing an offence under section 138 is a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.

Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under Chapter XVII.

Further Section 141(2) states that notwithstanding anything contained in sub-section(1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

*Explanation:* For the purposes of section 141 (a) "company" means anybody corporate and includes a firm or other association of individuals; and (b) "director", in relation to a firm, means a partner in the firm.

## Cognizance of Offences

As per Section 142(1) of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973 -

- (a) no court shall take cognizance of any offence punishable under Section 138 except upon a complaint, in writing, made by the payee or, as the case may be, the holder in due course of the cheque;
- (b) such complaint is made within one month of the date on which the cause of action arises under clause of the proviso to Section 138.

Clause (c) of the proviso to Section 138 provides that 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 fifteen days of the receipt of the said notice.

Provided that the cognizance of a complaint may be taken by the Court after the prescribed period, if the complainant satisfies the Court that he had sufficient cause for not making a complaint within such period;

- (c) no court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under Section 138.

Further, Section 142(2) provides that the offence under Section 138 shall be inquired into and tried only by a court within whose local jurisdiction—

- (a) if the cheque is delivered for collection through an account, the branch of the bank where the payee or holder in due course, as the case may be, maintains the account, is situated; or
- (b) if the cheque is presented for payment by the payee or holder in due course, otherwise through an account, the branch of the drawee bank where the drawer maintains the account, is situated.

*Explanation:* For the purposes of clause (a), where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then, the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course, as the case may be, maintains the account.

### Validation for Transfer of Pending Cases

Section 142A (1) of the Negotiable Instrument Act states that notwithstanding anything contained in the Code of Criminal Procedure, 1973 or any judgment, decree, order or direction of any court, all cases transferred to the court having jurisdiction under section 142(2), as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, shall be deemed to have been transferred under this Act, as if that sub-section had been in force at all material times.

As per Section 142A(2), notwithstanding anything contained in Section 142(2) or Section 142(1), where the payee or the holder in due course, as the case may be, has filed a complaint against the drawer of a cheque in the court having jurisdiction under section 142(2) or the case has been transferred to that court under Section 142(1) and such complaint is pending in that court, all subsequent complaints arising out of section 138 against the same drawer shall be filed before the same court irrespective of whether those cheques were delivered for collection or presented for payment within the territorial jurisdiction of that court.

Section 142A(3) states that if, on the date of the commencement of the Negotiable Instruments (Amendment) Act, 2015, more than one prosecution filed by the same payee or holder in due course, as the case may be, against the same drawer of cheques is pending before different courts, upon the said fact having been brought to the notice of the court, such court shall transfer the case to the court having jurisdiction under Section 142(2), as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, before which the first case was filed and is pending, as if that sub-section had been in force at all material times.

### Power of Court to try Cases Summarily

Section 143 (1) of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973 all offences under Chapter XVII of the Act shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of sections 262 to 265 (both inclusive) of the Code of Criminal Procedure, 1973 shall, as far as may be, apply to such trials.

Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees.

Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the Code of Criminal Procedure, 1973.

As per Section 143(2), the trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

Section 143 (3) states that every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

### Power to Direct Interim Compensation

Section 143A(1) Negotiable Instruments Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Court trying an offence under section 138 of the Negotiable Instrument Act, 1881 (Dishonour of cheque for insufficiency, etc., of funds in the account) may order the drawer of the cheque to pay interim compensation to the complainant—

- (a) in a summary trial or a summons case, where he pleads not guilty to the accusation made in the complaint; and
- (b) in any other case, upon framing of charge.

Section 143A (2) states that the interim compensation under sub-section (1) shall not exceed twenty per cent. of the amount of the cheque.

Section 143A (3), the interim compensation shall be paid within sixty days from the date of the order under sub-section (1), or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the drawer of the cheque.

As per Section 143A (4), if the drawer of the cheque is acquitted, the Court shall direct the complainant to repay to the drawer the amount of interim compensation, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

Section 143A (5) provides that the interim compensation payable section 143A may be recovered as if it were a fine under section 421 of the Code of Criminal Procedure, 1973.

As per Section 143A(6), the amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the Code of Criminal Procedure, 1973, shall be reduced by the amount paid or recovered as interim compensation under this section.

### Mode of Service of Summons

According to Section 144 of the Act, a Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by a Court of Session.

Where an acknowledgment purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorised by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the Court issuing the summons may declare that the summons has been duly served.

### Evidence on Affidavit

Section 145 of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any enquiry, trial or other proceeding under the Code of Criminal Procedure, 1973.

The Court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein.

### Bank's Slip Prima Facie Evidence of Certain Facts

According to Section 146, the Court shall, in respect of every proceeding under this Chapter, on production of Bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved.

## Offences to be Compoundable

Section 147 of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, every offence punishable under the Negotiable Instrument Act shall be compoundable.

## Power of Appellate Court to Order Payment Pending Appeal against Conviction

Section 148(1) provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, in an appeal by the drawer against conviction under section 138 of the Negotiable Instrument Act, 1881 (Dishonour of cheque for insufficiency, etc., of funds in the account), the Appellate Court may order the appellant to deposit such sum which shall be a minimum of twenty per cent. of the fine or compensation awarded by the trial Court.

The amount payable shall be in addition to any interim compensation paid by the appellant under section 143A.

Section 148(2) states that the amount referred to in sub-section (1) shall be deposited within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the appellant.

As per Section 148(3) the Appellate Court may direct the release of the amount deposited by the appellant to the complainant at any time during the pendency of the appeal:

It may be noted that if the appellant is acquitted, the Court shall direct the complainant to repay to the appellant the amount so released, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

## National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS)

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National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporates can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme.

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NEFT is an electronic fund transfer system that operates on a Deferred Net Settlement (DNS) basis which settles transactions in batches. In DNS, the settlement takes place with all transactions received till the particular cut-off time. These transactions are netted (payable and receivables) in NEFT whereas in RTGS the transactions are settled individually. For example, currently, NEFT operates in hourly batches. Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time. Contrary to this, in the RTGS transactions are processed continuously throughout the RTGS business hours.

The acronym 'RTGS' stands for Real Time Gross Settlement, which can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at the time they are received rather than at some later time; 'Gross Settlement' means the settlement of funds transfer instructions occurs individually (on an instruction by instruction basis). Considering that the funds settlement takes place in the books of the Reserve Bank of India, the payments are final and irrevocable.

**LESSON ROUND-UP**

- The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and Cheques.
- The term “negotiable instrument” means a document transferable from one person to another.
- A “promissory note” is an instrument in writing containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument.
- 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.
- Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.
- A ‘Cheque’ is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated Cheque and a Cheque in the electronic form.

**TEST YOURSELF**

*(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)*

1. Define negotiable instrument. Make a distinction between a Bill and a Cheque.
2. What is crossing of a cheque?
3. What is hundi? Describe some of the important hundis.



**EXECUTIVE PROGRAMME  
ECONOMIC BUSINESS AND COMMERCIAL LAWS (PAPER 7)**

**EP-EB&CL**

**WARNING**

It is brought to the notice of all students that use of any malpractice in Examination is misconduct as provided in the explanation to Regulation 27 and accordingly the registration of such students is liable to be cancelled or terminated. The text of regulation 27 is reproduced below for information:

“27. Suspension and cancellation of examination results or registration.

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo motu or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as student, or debar him from re-registration as a student, or take such action as may be deemed fit.

## EXECUTIVE PROGRAMME

### ECONOMIC BUSINESS AND COMMERCIAL LAWS

[This Test Paper is for recapitulate and practice for the students. Students need not to submit responses/answers to this test paper to the Institute.]

#### TEST PAPER

**Time Allowed: 3 Hours**

**Maximum Marks: 100**

All questions are compulsory

Marks for each question is indicated alongside of the question.

#### PART-I

- 1 (a) Discuss the salient features of Foreign Contribution (Regulation) Amendment Act, 2020.  
 (b) Discuss the functions of RBI with respect to Foreign Exchange Management function of RBI.  
 (c) Discuss the composition of Monetary Policy Committee under Reserve Bank of India Act, 1934.  
 (d) List out the prohibited Sectors specified under Foreign Direct Investment Policy 2020.

*(5 marks each)*

**Attempt all parts of either Q.No.2 or Q.No.2A**

2. (a) State the situations in which the drawal of foreign exchange is permitted under Schedule I to the Foreign Exchange Management(Current Account Transaction) Rules, 2000.  
 (b) Discuss briefly the class (es) of Capital Account Transactions under Foreign Exchange Management (Permissible Capital Account Transactions) Regulations, 2000.  
 (c) Discuss the remittances of foreign exchange by Individual for the acceptance of position of director in a company situated outside India.  
 (d) State the Authorities authorized to compounding of offence under Foreign Exchange Management Act, 1999.  
 (e) Issue of shares by XYZ Limited to Mr. X a Foreign National and delay in reporting inward remittance received for issue of shares without approval of Reserve Bank of India. State who is the compounding Authority in this case under the Foreign Exchange Management Act, 1999.

*(4 marks each)*

**OR (Alternate question to Q.No.2)**

- 2A (i) Discuss briefly star export house under Foreign Trade Policy.  
 (ii) Define Non-Banking Financial Company under RBI Act, 1934.  
 (iii) Enumerate recognised lender under External Borrowing Direction issued by Reserve Bank of India?  
 (iv) Briefly Discuss about Branch Office & Liaison Office.  
 (v) SEZ Authority undertake certain measures for the development, operation and management Special Economic Zone. State the measures undertake by the SEZ Authority.

*(4 marks each)*

#### PART- II

- 3 (a) Effective enforcement of Competition Law and active competition advocacy can also be powerful catalysts for successful economic restructuring. Comment.  
 (b) State bid rigging under Competition Act, 2002.

- (c) Define exclusive dealing under Competition Act, 2002.
- (d) State the persons who are entitled to appear before the Appellate Authority under Competition Act, 2002.
- (e) Competition Commission of India is a body corporate under Competition Act, 2002. Comment.

**(3 marks each)**

4. (a) Government Enterprises are also held liable for the Contravention of provisions of Competition Act, 2002. Critically examine.
- (b) Discuss Anti-Competitive Agreement under the Competition Act, 2002.

**(5 marks each)**

### **PART - III**

- 5 (a) State unfair trade Practice under Consumer Protection Act.
- (b) Discuss the Jurisdiction of National Consumer Council under the Consumer Protection Act, 2019.
- (c) Discuss the powers of the Central Government on fixing of price under Essential Commodities Act, 1955.
- (d) Discuss about pre-packaged declaration under Legal Metrology Act, 2009. Comment.
- (e) What is conditional transfer of property under Transfer of Property Act, 1882?

**(4 marks each)**

#### **Attempt all part of either Q. No. 6 or Q. No. 6A**

- 6 (a) "Where a person transfers his property so that his creditors shall not have anything out of the property, the transfer is called a fraudulent transfer". Examine the statement with respect to Transfer of Property Act, 1882.
- (b) "Real Estate Agent" and "Real Estate Authority" are same under Real Estate (Regulation & Development) Act, 2016. Discuss briefly.
- (c) What are the steps to be followed by promoters applying for Registration of real estate projects under Real Estate (Regulation & Development) Act, 2016?
- (d) Discuss the salient features of the Benami Transactions (Prohibition) Act, 1988
- (e) State the transactions or arrangements that are treated as benami transaction under Benami Transactions (Prohibition) Act, 1988.

**(3 marks each)**

#### **OR (Alternate question to Q. No. 6)**

- 6A (i) How does Money Laundering take place?
- (ii) What are the possible actions which can be taken against persons involved in Money Laundering?
- (iii) Discuss the circumstances when the authority of the banker to honour customer's cheque comes to an end.
- (iv) When the acceptance of the goods by the buyer takes place under Sale of Goods Act, 1930.
- (v) Indian Contract Act, 1872 lays down certain exceptions which make agreement without consideration valid and binding. Enumerate the exceptions.

**(3 marks each)**

