CHARTERED ACCOUNTANCY PROFESSIONAL (CAP) - III

CORPORATE LAWS

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Education Division

The Institute of Chartered Accountants of Nepal

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Education Division

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Preface

This study material is exclusively designed and developed for the students of Chartered Accountancy Professional [CAP]-III Level. It aims to deliver an expert knowledge of Nepalese corporate laws and their practical application.

We are confident that this study material will assist the students in their preparation for the exams. However, students are advised not to rely solely on this material. Students are advised to accustom with the syllabus of the subject and read each topic thoroughly for understanding on the chapter. They should update themselves and refer recommended text-books given in the CA Education Scheme and Syllabus along with other relevant materials in the subject.

Last but the most, we acknowledge the efforts of CA. Pramod Bhurji, who has meticulously assisted for preparation of this study material. Likewise, we also acknowledge CA. Pramod Lingden, who has reviewed this study material for building in comprehensive shape.

Due care has been taken to make every chapter simple, comprehensive and relevant for the students. In case students need any clarification, creative feedbacks or suggestions for further improvement on the material, they may be forwarded to Education Division of the Institute.

September, 2020

Education Division

The Institute of Chartered Accountants of Nepal

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CHAPTER- 1

NEPAL CHARTERED ACCOUNTANTS ACT, 2053 (1997) & REGULATION, 2061

1. INTRODUCTION

Nepal Chartered Accountants Act, 2053 was promulgated on 17th Magh 2053. The Act repealed the Auditors Act, 2031 (1975). The Council formed under section 7 of the Act has formulated the Nepal Chartered Accountants Rules, 2061 as per the power conferred to it by section 47(1) of the Nepal Chartered Accountants Act, 2053.

The objective of the Act as provided in the preamble of the Act is to establish an Institute of Chartered Accountants of Nepal in order to enhance social recognition and faith in accounting profession by raising public awareness towards the importance of the accounting profession, towards economic and social responsibility of the accountants and towards economic development of the country through the development of awareness among the professionals about their responsibility towards the importance of accountancy in order to develop, protect and promote the accounting profession.

Section 3 provides for the establishment of the Institute of Chartered Accountants of Nepal [*referred as 'Institute' under* clause (a) of *the Act]* for the development of the accounting profession. The Head Office of the Institute shall be located in Kathmandu Valley and the Institute may set up its training center, branch and sub-branch office in any place within Nepal.

Section 6 states that upon the establishment of the Institute pursuant to this Act, no any person shall be allowed to use the name or emblem resembling the name of the Institute, or to provide the certificate of any type to be granted by the Institute to any one, or to give directions of any type to any one on behalf of the Institute as well as to exercise any of such powers as may be exercisable by the Institute.

Nature of the Institute

Section 4 provides, the nature of the Institute shall be as follows:

- The Institute shall be an autonomous and body corporate with perpetual succession.
- The Institute shall have a separate seal of its own for its business.
- The Institute may like an individual, acquire, own, and dispose of or otherwise deal with movable and immovable property.
- The Institute may sue and also be sued in its name, like an individual.

Objective of the Institute

The objectives of the Institute shall be as follows:

- To play the role of a regulatory body to encourage the members to carry on accounting profession within the scope of the code of conduct in order to consolidate and carry on developing the accounting profession for the economic development of the nation.
- To enhance social recognition and faith in the accounting profession by raising awareness of the general public towards the importance of accountancy and the economic and social responsibility of the professional accountants.

- To develop, protect and promote the accounting profession by making the professional accountants understand their responsibility towards the importance of the accounting profession and accountancy.
- To develop registration, qualifications of accountingprofessional and examination system in consonance with international norms and practice so as to make the accounting profession respectable and reliable.

Fund of Institute and Accounts and Audit of Fund of Institute

Pursuant to section 36 of the Act, the Institute shall have a separate fund of its own & fund shall consist of following amounts:

- Grants received from Government of Nepal,
- Amounts received from any international or foreign organizations or institutions. Provided that, prior approval of Government of Nepal shall be obtained prior to obtaining such amounts,
- Amounts received while registering the names of members of the Institute or issuing Certificate of Practice,
- Amounts earned from the movable and immovable properties of the Institute,
- Amounts received by the Institute from any other sources.

  All amounts to be received by the Institute shall be credited to an account to be opened with any commercial bank within Nepal.

All expenditures to be incurred by the Institute shall be chargeable on the Fund. However, any amount received by for any specific purpose shall be spent for that purpose only. The Executive Director shall make expenses chargeable on the fund subject to control & supervision of Council. The account of the Institute shall be operated as prescribed by the Council.

The accounts of the incomes and expenditures of the Institute shall be maintained in the format as prescribed by the Council.The accounts shall be audited by a member having obtained the certificate of practice. Government of Nepal may, if it so wishes, inspect or cause to be inspected any documents relating to the accounts of the Institute at any time.

2. CONSTITUTION AND FUNCTIONS, DUTIES AND POWERS OF COUNCIL

Constitution of Council

Section 7(3) of the Act provides that a Council as follows shall be constituted for carrying out, or cause to be carried out, the programs necessary for the attainment of the objectives of the Institute in a well-planned manner and for monitoring and managing all the acts and actions of the Institute:

(a) 10 persons elected by the CA members from amongst themselves Member

(b) 4 persons elected by the registered auditor members from amongst themselves Member

(c) 3 persons nominated by Government of Nepal upon recommendation of the Auditor General, from amongstthe persons having experience on accountancy Member

The council members shall elect the president and the vice president from the fellow chartered accountants out of the council members referred to in clause (a) of section 7(3). The term of office of the president and the vice president shall be one year and upon the expiry of their term of office, they may be elected for one more term. The term of office of the council members shall be three years and upon the expiry of their term of office, they may be re-elected or re-nominated.

Rule 65 of the Nepal Chartered Accountants Rules, 2061 provides that President shall be the chief of the Council and shall have additional functions, duties and powers as follows in addition to the functions, duties and powers provided under section 10 of the Act:

- To direct Executive director to call meeting of the Council,
- To determine agenda of the Council meeting,
- To conduct the meeting of the Council and determine the priority of speakers among the Council members in the meeting,
- To adjourn the meeting of the Council if deemed necessary,
- To conclude the meeting of the Council,
- To represent the Institute,
- To make enquiry with executive director and council members as if when required.

Rule 66 provides that if the President is absent or the post of President is vacant, the Vice President shall perform the functions and duties and exercise the powers of President.

Circumstance Where Council Member Ceases to Hold Office

Section 8 of the Act provides that acouncil member shall cease to hold his or her office in any of the following circumstances:

- If the council member ceases to be a member of the Institute. However, this provision shall not be applicable to the nominated council member.
- If resignation tendered by the council member from his or her office is accepted by the Council. The President shall tender it to the vice President and the other council members to the President.
- If the council members absents himself or herself from three consecutive meetings of the Council without giving a notice with reason to the Council.
- If the term of office of the council members expires.
- If it is proved that the council member has not abided by the conduct referred to in Section 34.
- If the council member dies.

Section 9 of the Act has laid down the provisions of fulfillment of vacant positions of the council members. If the remaining term of office of any council member elected pursuant to clause (a) or (b) of sub-section (3) of Section 7, whose office has become vacant due to his or her death or resignation or being disqualified to be a member of the Institute pursuant to the provisions of this Act is less than one year, the Council shall designate as the council member to any member of

the Institute as referred to in the said respective clauses of sub-section (3) of the said section, and if such term is more than one year, the vacancy shall be filled by way of election.

Any office falling vacant owing to the death of any council member or resignation tendered by a council member nominated pursuant to clause (c) of sub-section (3) of Section 7, shall be fulfilled by nominating a person as the council member by following the procedures set forth in the said clause, for the remaining term of office of such council member.

Meeting and Decision of Council

As per section 10 of the Act, the Executive Director shall convene the meeting of the Council on such date and at such time and place as may be fixed by the President. The other provisions relating to the meeting and decision of the Council are as follows:

- The Council shall generally meet six times a year, and the interval between the two consecutive meetings shall not be more than three months.
- The president shall chair the meeting of the Council, and in his or her absence, the vice president. In the absence of both the president and the vice president, a council member selected by the council members from amongst themselves shall chair the meeting of the Council.
- If 25 % council members of the total number of council members make an application in writing to the president that it is necessary to convene a meeting of the Council, the President shall direct the Executive Director to convene a meeting of the Council within 15 days of such application.
- The presence of 50 % council members of the total number of council members shall be deemed to constitute a quorum for a meeting of the Council.
- The majority of opinion at a meeting of the Council shall be deemed to be a decision of the Council, and in the case of a tie, the person chairing the meeting shall exercise the decisive vote.
- The decisions of the Council shall be authenticated by the Executive Director.
- The Council may invite any officer of Government of Nepal, any national or foreign expert, advisor or highly reputed person related with the accounting profession to attend a meeting of the Council as an observer, if it deems so necessary.
- Other procedures relating to the meeting of Council shall be as determined by the Council itself.

Functions, Duties and Powers of Council

As per section 11 of the Act, the functions, duties and powers of the Council shall be as follows:

- To conduct examinations of candidates who join the accounting profession.
- To determine the procedures in relation to the membership of the Institute and registration of name as a member holding certificate of practice.
- To provide a person who holds the required qualification with an appropriate type of membership of the Council pursuant to Section 16.

- To make coordinative development of the accounting profession by having maximum utilization of the available means and resources.
- To determine the qualification required for efficient human resources for the development of the accounting profession.
- To determine the type of curriculum and practical training required to pursue the qualification necessary for obtaining the membership.
- To carry out different teaching and training programs in cooperation with any university or other educational institute by the Institute itself.
- To grant the certificate of practice to the members for carrying on the accounting profession.
- To enhance the capacity of members by providing them with career development opportunities.
- To monitor as to whether or not the members or members having obtained the certificate of practice have acted in conformity with the professional code of conduct prescribed for the members or members holding certificate of practice.
- In accordance with the recommendation of the disciplinary committee, to take necessary action against any members and members holding certificate of practice for their acts and actions in contravention of the professional code of conduct.
- To give theoretical or practical directions and guidelines in various aspects of the accountancy and auditing and carry out other functions as may be necessary for the professional development.
- To observe, or cause to be observed, accounting standards and standards on auditing provided or recommended by the Accounting Standards Board and Standards on Auditing Board, and to regulate whether such standards have been observed or not.
- To safeguard and promote the rights, interests and reputation of the members.
- To render advice and suggestion to Government of Nepal for the improvement of the various laws in force in the fields related with industry, commerce, finance, revenue and accounting profession
- To accept membership of the International Federation of Accountants, and regional and sub-regional federations, and establish contact with the accounting professional institutes of other countries.
- To recommend appropriate educational standards for accounting education in coordination with universities and other educational institutes.
- To conduct necessary trainings, symposia and seminars in order to enhance professional efficiency of the registered auditors.
- To conduct short term or long term trainings, symposia etc. for the benefit of accountancy human resources in service.
- To publish materials relating to the accounting profession.
- To operate a library relating to the accounting profession.
- To determine the procedures to be followed by the committees to be formed by the Council.
- To approve the budget of the Institute and manage the funds.

- To appoint such employees as may be required for the Institute and prescribe their remuneration and other facilities.
- To provide for continued professional education for members.
- To develop educational system in order to prepare Accounting Technicians and do necessary acts pertaining thereto.
- To carry out such other functions as are prescribed by this Act or the Rules and Bye-laws framed under this Act.
- To carry out such other functions as may be necessary for the attainment of the objectives of this Act.

Committees of Council

Section 13 of the Act provides that the Council may form the following standing committees in such a way that the members of one committee, except the president and the vice president, are not included in another committee:

- Disciplinary committee,
- Examination committee,
- Executive committee,
- Professional development committee.

The Committee shall be accountable to the Council. The Council may form other committees for the attainment of the objectives of the Institute as per necessity. The functions, duties and powers of the committees formed pursuant to this section shall be as prescribed.

Disciplinary Committee

Section 14 provides that there shall be a disciplinary committee as follows to inquire into a complaint and recommend the Council for necessary action in cases where any one lodges a complaint in the Institute that any member has done any act or action contrary to this Act or the Rules or code of conduct framed under this Act, or where the Institute receives such information:

(a) A FCA designated by the Council from amongst the council members referred to inclause (a) of sub-section (3) of Section 7 - Chairperson
(b) Three persons nominated by the Council from amongst the council members- Member
(c) Two persons nominated by the Council from amongst the members - Member
(d) One person nominated by the Auditor General - Member

The chairperson or any member of the disciplinary committee shall not be entitled to take part and cast vote at a meeting which is to be held to inquire into a complaint made that the chairperson or the member has done any act and action contrary to this Act or the Rules, byelaws or codes of conduct framed under this Act and to make recommendation to the Council for necessary action.

The procedures relating to the meeting of disciplinary committee and the term of office of the chairperson and members of the disciplinary committee shall be as prescribed. The disciplinary

committee shall have the same powers as are vested in the court in respect of issuing an order to the concerned person, receiving evidence and examining witnesses. Rule 68 provides that the function, duties and power of Disciplinary Committees in addition to the function, duties and powers pursuant to section 14 of the Act are as follows:

- Conduct investigation on complaints filed under section 35 of the Act against any member,
- Obtain opinion from legal advisors and experts during investigation process,
- Present investigation report along with recommendation for punishment to the council,
- In case of false complaint, recommend the council to take action against such complainant,
- The Disciplinary Committee shall submit the annual report of acts and activities performed to the Council,
- Other functions as prescribed by the council

The disciplinary committee shall make recommendation, along with its opinion and finding to the Council for taking necessary action against a member found guilty from its investigation. The Council may, in view of recommendation of the disciplinary committee, impose any of the following penalties on the concerned member according to the gravity of the offence:

- Reprimanding,
- Removing from the membership for a period not exceeding 5 years,
- Prohibiting from carrying on the accountancy profession for any specific period,
- Canceling the certificate of practice or membership.

If the disciplinary committee, upon investigating the matter that any council member has done any act or action contrary to this Act or Rules, bye-laws or code of conduct framed under this Act, has made recommendation along with its opinion and findings to the Council for instituting necessary action against the council member, such council members shall not be entitled to take part and cast vote at the meeting of the Council while taking decision by the Council on such recommendation.

The Council shall provide a reasonable opportunity to the concerned member to defend himself/herself before imposing any penalty.The concerned member may make an appeal to the High Court, if he or she is not satisfied with the decision of the Council

Executive Committee

Section 15 provides that there shall be formed an executive committee comprising of the following members in order to carry out the day-to-day business of the Institute, under the direction of the Council:

(a) President	Chairperson
(b) Vice-President	Vice chairperson
(c) Two persons nominated by the Council from amongst the Council Members	Member
(d) Executive Director	Member-secretary

Examination Committee

Rule 69 provides, the Examination Committee shall be constituted as follows:

(a)	President of the Council	Chairperson
(b)	Vice-President of the Council	Vice-chairperson
(c)	3 persons nominated by the Council from amongst the Council Members	Member
(d)	2 persons nominated by the Council from amongst the members	Member

The tenure of office of members of Examination Committee shall be 1 year and they may be re-nominated.

Professional Development Committee

Rule 71 provides, the Professional Development Committee shall be constituted as follows:

(a)	President of the Council	Chairperson
(b)	Vice-President of the Council	Vice-chairperson
(c)	3 persons nominated by the Council from amongst the Council Members	Member
(d)	2 persons nominated by the Council from amongst the members	Member

The tenure of office of members of Professional Development Committee shall be 1 year and they may be re-nominated.

3. ACCOUNTING STANDARDS BOARD AND STANDARDS ON AUDITING BOARD

Formation of Accounting Standards Board

Section 15A provides, Government of Nepal shall form an Accounting Standards Board consisting of the following members in order to systematize and regulate the accountancy profession and financial reports:

(a)	1 person nominated by Government of Nepal from amongst the FCA	Chairperson
(b)	Representative, Ministry of Finance	Member
(c)	Representative, Office of Auditor General	Member
(d)	Representative, Financial Comptroller General Office	Member
(e)	Registrar, Office of Company Registrar	Member
(f)	Director General, Inland Revenue Department	Member
(g)	Chairperson or representative designated by Chairperson, Securities Board	Member
(h)	5 persons nominated by Government of Nepal from amongst the Chartered Accountants, upon the recommendation of the Council	Member
(i)	1 person nominated by Government of Nepal from amongst the Registered Auditors, upon the recommendation of the Council	Member

The Accounting Standards Board may invite any concerned expert to attend its meeting as an observer if it deems so necessary. The term of office of the members mentioned in (a), (h) and (i) above shall be three years and they may be re-appointed or nominated on the expiry of their

term. The rules of procedures relating to the meeting of the Accounting Standards Board shall be as determined by the Board itself. The secretariat of the Accounting Standards Board shall be situated in Head Office of Institute.

Functions, Duties and Powers of Accounting Standard Board

Section 15B provides the functions, duties and powers of the Accounting Standards Board shall be as follows:

- To provide for accounting standards based on international accounting standards in order to systematize and regulate the accountancy and financial reports,
- To prepare appropriate modalities in order to develop accounting standards and publish materials relating to accounting standards,
- To amend, improve and revise accounting standards,
- To interpret accounting standards,
- To perform other acts relating to accounting standards.

Circumstance where Member of Accounting Standards Board Ceases to Hold Office

Section 15C provides, a member of the Accounting Standards Board shall cease to hold his or her office in any of the following circumstances:

- If the member tenders resignation,
- If the member absents himself or herself for three consecutive meetings of the Accounting Standards Board without giving a notice,
- If the member is convicted by a court of a criminal offence involving moral turpitude and punished for such offence,
- If the member becomes insane,
- If the member dies,
- If in the case of a member of the Institute, the name of the member is removed from the membership register pursuant to Section 22.

Formation of Standards on Auditing Board

Section 15D provides, Government of Nepal shall form a Standard on Auditing Board consisting of the following members in order to systematize and regulate the accounting profession and auditing:

(a)	1 person nominated by Government of Nepal from amongst the FCA	Chairman
(b)	Representative, Ministry of Finance	Member
(c)	Representative, Office of Auditor General	Member
(d)	3 persons nominated by Government of Nepal from amongst the Chartered Accountants, upon the recommendation of the Council	Member
(e)	1 person nominated by Government of Nepal from amongst the Registered Auditors, upon the recommendation of the Council	Member

The Standards on Auditing Board may invite any concerned expert to attend its meeting as an observer if it deems necessary. The term of office of the members mentioned in (a), (d) and (e)

above shall be three years and they may be re-appointed or nominated on the expiry of their term. The Rules of procedures relating to the meeting of the Standards on Auditing Board shall be as determined by the Board itself.The secretariat of the Standards on Auditing Board shall be situated in the Head Office of the Institute.

Functions, Duties and Powers of Standards on Auditing Board

Section 15E provides the functions, duties and powers of the Standards on Auditing Board shall be as follows:

- The functions, duties and powers of the Standards on Auditing Board shall be as follows:
- To provide for standards on auditing based on international standards on auditing in order to systematize and regulate the accountancy and financial reports,
- To prepare appropriate modalities in order to develop standards on auditing and publish materials relating to standards on auditing,
- To amend, improve and revise standards on auditing,
- To interpret standards on auditing,
- To perform other acts relating to auditing standards.

Circumstance Where Member of Standards on Auditing Board Ceases to Hold Office

Section 15F provides,a member of the Standards on Auditing Board shall cease to hold his or her office in any of the following circumstances:

- If the member tenders resignation,
- If the member absents himself or herself for three consecutive meetings of the Standards on Auditing Board without giving a notice,
- If the member is convicted by a court in a criminal offence involving moral turpitude and punished for such offence,
- If the member becomes insane,
- If the member dies,
- If in the case of a member of the Institute, the name of the member is removed from the membership register pursuant to Section 22,

4. MEMBERSHIP OF THE INSTITUTE

Membership of Institute

Section 16 provides that the membership of the Institute shall be divided into the following classes:

- Chartered Accountant,
- Registered Auditor

Sub-section (2) provides, the membership of Chartered Accountant shall, subject to Section 18, be given to a person having possessed the following qualification:

- One who has a certificate of registered auditor of class 'A' pursuant to the Auditors Act, 2031 (1975) or a certificate of registered auditor of class 'B" based on the ground of having

passed the chartered accountancy examination, at the time of the commencement of this Sub-Section.

- One who has passed the chartered accountancy examination or equivalent thereof from the Institute or foreign accounting professionalinstitute recognized by the Institute and obtained professional training relating to the accounting profession. As per Rule 41A, any person who has passed the chartered accountancy examination from any foreign accounting professional institute shall have completed minimum internship period (currently 1 year) to be eligible for the membership.

Similarly, sub-section (3) provides, the membership of registered auditor shall, subject to Section 18, be granted to a person who has obtained the certificate of auditor of class 'B', 'C', or 'D' pursuant to the Auditors Act, 2031 (1975) at the time of the commencement of this Sub-Section (3).

Fellow Chartered Accountant

The membership of fellow Chartered Accountant may be granted to the following members in such manner as prescribed:

- Those who have obtained the certificate of registered auditor of class 'A' pursuant to the Auditors Act, 2031 (1975), at the time of the commencement of Section 17 of this Act,
- The CA members who have been engaged in the accounting profession for at least Five years.

Disqualification for Membership Registration

Section 18 provides that the following person shall not be deemed to be qualified to be enrolled as a member of the Institute:

- One who has not the qualification referred to in sub-sections (2) and (3) of Section 16,
- One who has not attained the age of 21 years,
- One who has become insolvent being unable to repay loan to creditors,
- One who has beenconvicted by the court in acriminal offence involving moral turpitude,
- One who is of unsound mind or insane.

Process of Membership Registration

Section 19(1) provides, if a person, who has possessed the qualification referred to in this Act, intends to become a member of the Institute shall submit an application setting out the details as prescribed to the Institute in the format as prescribed.The fees as prescribed shall be paid for the purpose of obtaining membership of the Institute.

Further sub-section (3) provides special provision for the Registered Auditors. Where a person having eligible qualification to obtain the membership of Registered Auditor desires to have his or her name registered in the membership of the Institute, he or she shall submit an application to the Institute no later than six months after the date of the commencement of Sections 29 and 49 of this Act, by Government of Nepal upon notification in the Nepal Gazette (2059/4/1). A person

who fails to submit an application for the membership within that period shall not be entitled to obtain the membership as referred to in this Act.

Section 20 provides if a person making application under section 19(1) is found to be eligible to be enrolled as a member of the Institute, the Council shall register the name of such person in the membership of the Institute. It shall grant the certificate of membership registration with setting out the class of member in the format as prescribed. The Institute shall maintain separate membership registration book as prescribed as per the class of membership.

Provision on Removal and Re-registration of Name of Member

Section 22(1) of the Act provides that the Council may issue an order to remove the name of any member from the membership register, in any of the following circumstances:

- If the member is convicted by a court of a criminal offence involving moral turpitude and punished for such offence,
- If the member fails to pay the fees required to be paid to the Institute,
- If the member fails to abide by the professional conduct referred to in this Act and the Rules framed under this Act,
- If the member becomes insane,
- If the member dies.

Sub-section (2) provides provisions for re-registration of membership. If a person whose name has been removed from membership makes an application, accompanied by a reasonable ground to again obtain membership, the Council may decide to grant membership by re-registering his or her name, upon receipt of the fees as prescribed.

If an information is received that the name of any person has happened to be registered in the membership of the ICAN by fraud or mistake and such matter is found to be true upon holding an inquiry into the matter, the Council may cancel the membership registration certificate of such person, and also the certificate of practice, if any, granted to such person. A notice thereof shall be published in a newspaper.

Payment of Annual Membership Fee/Renewal of Membership

Rule 46 provides that every member shall renew his/her membership by paying annual membership fee as prescribed by the Council from time to time within 60 days of commencement of fiscal year and completing Continued Professional Education (CPE) hours pursuant to Rule 55(1). If the member fails to renew the membership within 60 days of expiry of fiscal year, he/she may renew the membership within next 60 days by paying additional fee of 15%. The member may renew the membership within next 60 days by paying additional fee of 25%. The membership of the member who has not paid the membership fee within the extended time limit and not completed CPE hours pursuant to Rule 55(1) shall be ipso facto cancelled.

The Act has provisions for advance payment of membership fee for future years. Any member may pay membership fee in advance for any number of years. If there is any change in the annual membership fee, the membership fee paid in advance shall be adjusted accordingly.

5. CERTIFICATE OF PRACTICE

Certificate of Practice (COP)

Certificate of Practice means the certificate required to practice accountancy in a professional manner.A member who intends to provide auditing service shall make an application in the format as prescribed to the Institute to obtain the certificate of practice. If the applicant has fulfilled the terms as prescribed, the Council shall grant the certificate of practice in the format as prescribed to such member. The Council may determine the terms for the members who have obtained the certificate of practice and require them to observe such terms, and make and enforce the code of conduct for such members.

Suspension of Certificate of Practice

Rule 52 provides, the Certificate of Practice of any member shall be suspended in the following circumstances:

- If it is prohibited to any member by the Council not to carry accounting profession for a certain period pursuant to clause (c) of sub-section 5 of section 14 of the Act,
- If the member applies for suspension of the COP to the council for a certain period,
- Not completed required Continued Professional Education (CPE) hours pursuant to Rule 55,
- If the RA member has enrolled in Chartered Accountancy course, during the period of articleship.

Registration of Accounting Profession Firm

Section 28A of the Act provides that if a member who has obtained the certificate of practice intends to operate auditing service by the name of an accounting profession firm, the member shall make an application in the format as prescribed to the Institute for the registration of such firm. The procedures relating to the registration of the accounting profession firm shall be as prescribed. After the prescribed procedures have been fulfilled, the Council shall grant the certificate of registration of accounting profession firm in the format as prescribed.

Carrying of Accountancy Profession by Foreign Citizens

Rule 56 has laid down provisions relating to carrying of accountancy profession by foreign citizens. Notwithstanding anything contained anywhere in this Nepal Chartered Accountants Rules, 2061, any foreign citizen eligible according to these rules can perform accountancy profession in Nepal only after registering a firm in partnership with a citizen of Nepal. Nature, scope and limitations of the firm in partnership with Nepalese citizen shall be as decided by the council. Notwithstanding anything contained anywhere in this Nepal Chartered Accountants Rules, 2061, a foreign citizen performing accountancy profession acquiring membership from the Institute of Chartered Accountants of Nepal at the time of commencement of this Rules shall have to register a firm in partnership with Nepalese citizen within 2 years of the date these rules came into effect. The share of a foreign citizen as a partner in an accounting firm shall not exceed 51 %.

Ceiling of Auditing

Rule 53 provides that the ceiling of auditing which the members who have obtained the certificate of practice can carry out shall be as follows:

(a) Chartered Accountant: Any amount
(b) 'B' Class Registered Auditor: up to NPR 100 crores
(c) 'C' Class Registered Auditor: up to NPR 25 crores
(d) 'D' Class Registered Auditor: up to NPR 5 crores

The Council shall alter the limit in every 3 years on the basis of wholesale price index published by Nepal Rastra Bank and if it alters the limit, it shall be fixed so as to be applicable with effective from 1st of Shrawan of the same year.

6. CODE OF CONDUCT

Code of Conducts are the set of norms, ethics and standards to be observed or followed by a professional in his/her profession. The code of conduct are to be followed by members or members holding certificate of practice in his profession. These are the rules designed to make the profession reliable and trustworthiness. Further, the professional respect, integrity and dignity which are top most important for the profession can be maintained through due observance of these code. On the other hand, the code of conducts are not only the guidelines but binding rules. Hence, if a member of the Institute fails to abide the code of conducts, he/she can be charged and punished as prescribed in the Act. Section 34 of the Act has provided following code of conducts to be observed by the member or members holding certificate of practice:

(a) The member and member holding certificate of practice shall fully observe this Act or the Rules framed under this Act.
(b) No member shall carry out auditing in collaboration by way of partnership or otherwise with any person who has not obtained the certificate of practice of his or her class.
(c) No member shall make any kind of partnership in the audit fees or remuneration received or earned by, or sharing in the profits made by, that member with any person other than a person who has obtained membership of the Institute. No member shall give commission, brokerage etc. from the professional fees which he or she has received or earned to any person including a person who has obtained membership.
(d) No member shall, showing fear, terror, swank or influence, whether directly or indirectly, any person in order to get the business of accountancy practice.
(e) No member shall supply or disclose any information and explanation which he or she has got in the course of his or her business to any person other than the person who employs him or her and the person to whom he or she is compelled by the laws in force to supply or disclose such information and explanation.
(f) No member having obtained the certificate of practice shall certify any financial returns or make any kind of report without making examination and verification by himself or herself or his or her partner or employee.

(g) While making any kind of report or certifying any financial returns of an organization in which he or she or his or her partner has interest, a member having obtained the certificate of practice shall also clearly set down that he or she or his or her partner has such interest. Provided that, where such member is merely a shareholder of a company, he or she shall not be deemed to have an interest.

(h) A member having obtained the certificate of practice shall clearly show any material details known to him or her in order to actually reflect any financial statements certified by him or her. He shall also clearly mention the false details or explanations, if any, inherent in the financial statements certified by him or her, to the best of his or her information.

(i) A member holding certificate of practice shall carefully perform the duties required to be performed in the course of practicing his or her profession. He shall draw attention of all the concerned towards any material things which are not or have not been done in consonance with the laws in force and the recognized principles on auditing.

(j) No memberholding certificate of practice shall base the remuneration to which he or she is entitled for his or her work on a percentage of profits or on any other uncertain result.

(k) No member shall knowingly or recklessly mention any false matter in any notice, explanation or statement required to be given to any office or department of Government of Nepal or any organization.

(l) No member holding certificate of practice shall carry out auditing of an organization for which he or she has served, prior to the expiry of at least three years of his or her retirement from the service of that organization.

(m) No member having obtained the certificate of practice shall accept his or her appointment as an auditor of any organization without ascertaining that the procedures required by the laws in force for appointment as an auditor have been fulfilled.

(n) A member shall obtain ample related information prior to expressing his or her opinion about auditing.

(o) Other matters relating to conduct to be observed by the member and the member having obtained the certificate of practice shall be as prescribed.

Complaint against a Member

Section 35 of the Act provides, if a member having obtained the certificate of practice does not observe the conduct set forth in this Act or the Rules framed under this Act or such member violates this Act or the Rules framed under this Act, the concerned person may make a complaint to the Institute against such member. If there is found a fact to believe that a member or member holding the certificate of practice has not observed the conduct required to be observed, the Executive Director shall submit a proposal to the Council accompanied by the available fact for taking action against such member or member holding certificate of practice.

7. MISCELLANEOUS

Recognition of Educational Qualification

Section 26 of the Act provides a person who has passed the chartered accountancy or equivalent examination there to and taken training from any foreign accounting professional institute shall make an application as prescribed to the Institute for the recognition of such examination and training. If an application is so made for recognition, the Council shall make decision to or not to recognize such examination and training.

If the Council holds that any term has to be fulfilled by the applicant prior to recognizing the examination and training, such term shall also be specified. If any term to be fulfilled is so specified to the applicant, an application may be made for the membership of the Institute under this Act only after the fulfillment of such term.

Section 27 provides provisions relating to recognition of foreign accounting professional institute. The Council may with the prior approval of Government of Nepal recognize any foreign accounting professional institutes and the examinations and trainings held and provided by such institutes. The Council shall maintain a list of recognized institutes. It shall not be necessary to fulfill the procedures set forth in section 26 in relation to any examinations held and trainings provided by such recognized institutes.

Executive Director

The Council shall appoint any person who has experience in accountancy to the post of Executive Director in order to carry out administrative activities of the Institute. The Executive Director shall act under supervision and control of the Council. The term of office of the Executive Director shall be four years, and the Council may, if it so wishes re-appoint him or her. The Council may designate any officer employee of the Institute to perform the functions of the Executive Director during his/her absence.

The functions, duties and powers of the Executive Director shall be as follows:

- To be responsible to the Council and act as the chief executive of the Institute,
- To perform the day-to-day administrative business of the Institute,
- To prepare the annual budget of the Institute and submit it to the Council,
- To maintain, or cause to be maintained, the accounts of the Institute,
- To take custody of and update, or cause to be updated the register of members and members having obtained the certificate of practice (COP).

Offenses and punishment

The Act has provided provisions of punishment to be imposed for violation of laws and rules with a view to make accounting profession trustworthiness, responsible and reliable. Section 41 of the Act provides following provisions relating to offenses and punishment:

- A person, who carries out audit without obtaining a Certificate of Practice, pursuant to this Act, shall be liable of punishment with a penalty of maximum two thousand rupees or with an imprisonment for a maximum period of three months or with both.

- A person, who in contravention of Section 6 uses the name or the seal of the Institute or exercises any type of authority bestowed to the Institute, shall be punished with a penalty of one thousand rupees maximum on first conviction, and on any subsequent conviction there after, a maximum penalty of five thousand rupees or imprisonment for a maximum period of six months or both. However, this shall not apply to any statutory body corporate or university or organizations associated with such body.
- A person, who has not obtained a Certificate of Practice and is proved to have signed any document in capacity of the member holding Certificate of Practice, shall be liable to punishment with a penalty up to two thousand rupees or imprisonment for a period of up to three months or both.
- A member, who commits any act contrary to the provisions of this Act or Regulations framed under this Act other than the provisions of this section, shall be suspended for a maximum period of five years and shall be liable of punishment with a maximum penalty of two thousand rupees or imprisonment for a maximum period of three months or both.
- A complainant who lodges a complaint, without any reasonable cause to make complaint and it is proved that the complaint was made with an intention to harass a member, shall be liable to punishment with fine up to one thousand rupees.
- The complaint cases, except those to be heard under Section 14, lodged in the Council against any member, pursuant to Section 35, shall be instituted in the concerned High Court.

Formation of Adhoc Council

Section 42 provides, an adhoc council shall be formed pending the formation of the Council pursuant to section 7. The adhoc council shall perform the functions to be performed by the Council under this Act in relation to issue the membership registration certificate by registering the name of a person who has the qualification to become a member of the Institute and to hold election of the council members representing the members to the Council. The adhoc council shall consist of the following members:

(a) President, Association of Chartered Accountants of Nepal - Chairperson
(b) 3 persons nominated by Government of Nepal from amongst the auditors who have been registered as auditors under the Auditors Act, 2031 (1975) - Member
(c) Gazetted first class officer designated by Government of Nepal - Member Secretary

The adhoc Council shall determine the rules of procedures of its meetings and other modus operandi on its own. The adhoc Council shall complete election of the council members representing the members to the Council no later than 6 months after the date of the commencement of this Act. The adhoc council shall ipso facto be dissolved upon the formation of the Council pursuant to Section 7. After the adhoc council is so dissolved, all acts and actions done and taken by that adhoc Council on behalf of the Council shall be deemed to have been done and taken by the Council itself.

Power of Government of Nepal and Auditor General to Give Directives

Section 44 provides, Government of Nepal may give necessary direction to the Council in relation to the activities of the Institute. The Auditor General may give necessary direction to Council in relation to development, protection & promotion of the accounting professional. It shall be the duty of the Council to abide by the direction given by Government of Nepal or Auditor General.

CHAPTER- 2

COMPANIES ACT, 2063

1 INTRODUCTION

The company, incorporated under the successive Companies Acts, is a dominant institution in our society, all the more so with the retreat in recent decades of the government owned or public sector of the economy from a number of areas in which it previously had been a monopoly or near monopoly provider of service or, less often, of goods. Yet, the role of the company incorporated under the Companies Act is not easy to describe with accuracy. Even in the area of profit making business activity, where it is a major force, it has no exclusive position and faces competition, at least in relation to smaller businesses, from other legal forms, such as the partnership or the sole trader (if the latter is a legal form at all). Moreover, the company is not just a vehicle for making profits: it can be, and is increasingly, used in the not-for-profit sector, i.e. where the aim of the undertaking is either not to make profits, or, if it is, not to distribute them to the members of the company.

Above all, the company is a highly flexible form of vehicle for carrying on business, whether for profit or not-for-profit. Thus, companies can be used to accommodate the smallest, one-person business to the largest, multi-national undertaking. The characteristics of the corporate form which give it such flexibility obviously deserve to be studied.

Types and Functions of Companies

Although company law is a well-recognized subject in the legal curriculum and the title of a voluminous literature, its exact scope is not obvious since "the word company has no strictly legal meaning regarding its nature". Explicitly or implicitly, many courses on "company law" solve the problem by defining the company as the company incorporated under section 2(a) of Companies Act, ***2063***. Since there are more than a million such companies existing today, in practical and pragmatic terms this is a sensible solution, for clearly the law applying to such companies is a matter of major concern to many people.

According to Gower, "the term company" implies an association of a number of people of some common object or objects. The purposes for which men and women may wish to associate are multifarious, ranging from those as basic as marriage and mutual protection against the elements to those as sophisticated as the objects of the Federation of Industry or a political party. However, in common parlance the word "company" is normally reserved for those associated for economic purposes, *i.e*. to carry on a business for gain. However, to say that company law is concerned with those associations which people use to carry on business for gain would be wrong in Nepalese context for three reasons. First, the law provides vehicles in addition to the company in which people can associate for gainful business. Second, companies incorporated under the Companies Act may be used for carrying on not-for-profit business or for purposes which can by only doubtfully characterized as business at all. Third, a company may be incorporated by a single promoter shareholder as well. Let us look at each of these matters in turn:

(A) Companies and Partnership (Limited and Unlimited)

Law provides two main types of organization for those who wish to associate in order to carry on business for gain: partnerships and companies. Although the word "company" is colloquially

applied to both, the modern lawyer regards companies and company law as distinct from partnerships and partnership law. Partnership law, which is now largely codified in the Partnership Act 2020, is based on the law of agency, each partners becoming an agent of the others, and it therefore affords a suitable framework for an association of a small body of persons having trust and confidence in each other. The present Companies Act permits private companies formally to be capable of being formed with a single shareholder.

Where a large and fluctuating number of shareholders is involved, the Company form has distinct advantages as an organizational form. This is because the company has built into it a distinction between the members of the Company (usually shareholders or member) and the management (vested in a board of directors). This division is inherent in Company Law and so the Company legal form deals comprehensively with the consequences of the division between ownership and management.

In other countries, Limited Liability Partnership Acts are enacted to introduce a new hybrid legal vehicle. Although a hybrid, Limited Liability Partnership (LLP) is much nearer to a company. The LLP is governed by Company Law; often adapted to its Partnership needs, rather than by partnership law, except in two crucial aspects. In particular, LLP has the separate legal personality and limited liability of the Company, whereas under partnership law, the partnership is never considered to have separate legal personality and the partners are fully liable for the debts of the partnership.

(B) Companies not Distributing Profit

A Company may be not-for-Profit one in a strong sense, in that provision in its constitution prohibits the distribution of profits to the members of the Company, even though the Company may be making profits for itself out of its activities. The purpose which such Companies pursue may be genuinely charitable (in which case it will have to abide by any charitable legislation and Company legislation) or they may be public interest purpose which do not fall within the rather narrow legal definition of charitable purpose or they may be private but not profit making purpose.

A typical example is the tenants of a block of flats of a Company to hold the legal title in the Company or to see to the care and maintenance of the common parts of the block by contributing services charge, simply to the level needed to discharge its obligation and would be surprised if the Company made a significant profit on the activities.

In England, the Financial Reporting Council which regulates the corporate affairs and governance is a public limited company with all its other bodies like Accounting Standards Board, Auditing Practices Board, the Financial Reporting Review Panel, the Accountancy Discipline and Investigation Board and the Professional Oversight Board for Accountancy, as its subsidiary companies.

The Functions of the Modern Company

So far, we have established two negative, and therefore not wholly helpful, propositions. First, the company form is not limited to the association of large number of people in the carrying on of a business, but can be used by small numbers, even by the individual entrepreneur. Second, the company form is not refined to the carrying on of a profit- making activity only. However, the comparative advantage of the company (as against, for example, the partnership or the trust) does indeed lie in the association of large numbers of people for the carrying on of large-scale business. This is for two reasons. First, company law, by insisting upon the central role of directors in the running of the company, permits a large and fluctuating body of members (the shareholders) to delegate oversight of the company‘s business to a small and committed group of persons (the directors). As important, over the years successive Companies Acts and, especially, the common law have developed a set of rules for regulating the relationship between shareholders and directors when authority is delegated to the directors in this way. Second, by providing for the creation of separate legal personality, limited liability and transferable shares, company law facilitates the raising of risk capital from the public for the financing of corporate ventures.

From a functional viewpoint, it could be said that today there are three distinct types of company:

1. Companies formed for purposes other than the profit of their members, *i.e*. those formed for social, charitable or quasi-charitable purposes. In this case incorporation is merely a more modern and convenient substitute for the trust.
2. Companies formed to enable a single trader or a small body of partners to carry on a business. In these companies, incorporation is a device for personifying the business and, normally, divorcing its liability from that of its shareholders despite the fact that the shareholders retain control and share the profits.
3. Companies formed in order to enable the investing public to share in the profits of an enterprise without taking any part in its management. In this last type, which is economically (but not numerically) by far the most important, the company is again a device analogous to the trust, but this time it is designed to facilitate the raising and putting to use of capital by enabling a large number of owners to entrust it to a small number of expert managers.

There may be hybrid companies or companies which in a particular moment of their growth straddle the second and third categories. For example, a company which was formally controlled wholly by the members of a particular family may have begun to bring in one or two outside financiers (sometimes called ‘business angels’) in order to expand the business and these outsiders will naturally have wanted a share in the control of the company. At a later date, the family members may have retired from active management of the company may have brought in professional managers to run the company (to whom shares have been allocated), but the family members may still be the predominant shareholders.

Second, even if a company is squarely within the third category and has a large number of shareholders, from whom the directors constitute a distinct body, there may be great variations in extent to which the shareholdings are dispersed and the ease with which those shares can be traded. At one end of the scale is a company listed on the Stock Exchanges with many thousands of shareholders who are able to trade their shares with other investors with great ease; whilst at the other end is a company which does in fact have several hundred shareholders, many of whom

are perhaps its employees, but which has never made a formal offer of its shares to the public and whose shares may not be traded on a public exchange.

Different Types of Registered Companies

The distinction between public and private companies is embodied in the Act, but, unlike in many continental European countries, there is no separate legislation for public and private companies. The approach of the single Act seems to be feasible because, although public companies are more highly regulated than private companies, the legislation has always had less ambitious regulatory goals for public companies. Thus, for example, the German *Aktiengestez*, applying to public companies, divides the board of directors into two bodies, the supervisory board and the management board, and deals in some detail with the allocation of functions between them and the method of appointment of their members. By contrast, the British Act says very little about what the board is to do or how its members are to be appointed, and certainly does not require the creation of separate supervisory and management boards. These matters are left to be decided by each company itself in its constitution. Consequently, different sizes and types of company can adjust these matters to suit their own particular situation. Whereas in Germany to relieve private companies of the demands of the *Aktiengesetz* has been seen to require the enactment of a separate and more flexible statue for private companies the *Gmb H Gesetz.*

Given the significance of the distinction between public and private companies in the present Companies Act and the likely increase in the importance of that distinction in the future, it is important to see that the choice between a public and a private company is one for the incorporators themselves or, after incorporation, for the shareholders. That choice isexpressed in the company‘s memorandum of association. In fact, the default rule is that the company is public: unless the company states that it is to be registered as a private company, it will be a public one.

A company could qualify as private only if it (a) limited its membership to 101, (b) restricted the right to transfer shares to any person other than its shareholder without fulfilling the procedures contained in the article, memorandum or consensus agreement, and (c) prohibited any invitation to the public of its shares.

(A) Listed and Other Publicly Traded Companies

Offering shares to the public and arranging for those allotted shares to be traded on a public securities market are two separate things. However, the public‘s willingness to buy the shares offered is likely to be increased if the shares will be traded on a public securitiesmarket. This is because a public share market makes it much easier for a shareholder subsequently to sell his or her shares to another investor (or to purchase more shares in the company), should he or she wish to do so. Consequently, public offerings of shares and the introductions of those shares to trading on a public securities market often go together.

By and large, the Companies Act makes very few differentiations according to whether a company‘s shares are publicly traded or not. However, by virtue of the rules applying to that market, a company which chooses to have its shares listed on a public securities market may

incur obligations which supplement those to be found in the Act. The most important example arises because a company seeking to have its shares traded on the main market of the Stock Exchange must first have them admitted to the 'Official List' of securities, which list is maintained by Nepal Stock Exchange (NEPSE) acting in its capacity as the secondary securities market. The SEBON and NEPSEare also empowered to impose on listed companies rules governing their conduct thereafter. Such listing rules relate mainly to the orderly conduct of the public share market, but they also contain rules regulating the internal affairs of companies, which thus supplement the provisions of the Companies Act and the common law of companies. Within Europe, the British listing rules are unusual in the extent to which they are used to promote corporate governance and shareholder protection objectives, in addition to market efficiency.

In India , Securities Exchange Board prescribes the Listing Rules and according to Rule 41, that every listed public company should publish audited/ unaudited quarterly financial results within two months /one month from the end of the respective quarters in the newspapers, for the information of members and investors.

The identification of publicly traded companies as a separate group for company law purposes has shown significant development in recent years and it is unlikely that the importance of this category will diminish in the future.

(B) Micro Companies

We now turn to two other possible classifications of companies, which, however, are not currently embedded in the legislation. At the other end of the scale from the listed company, there is very small company or micro company where the directors and the shareholders are the same people and where the size of the business carried on is also small.

Unregistered Companies and Other Forms of Incorporation

We now move beyond an analysis of different types of registered companies to look at forms of incorporation, alternative to registration under the Companies Act, which are available even for the carrying on of large-scale business. When the machinery for the formation of a company by registration under a general Act of Parliament was introduced in 2007, other methods of forming companies by special Act of Parliament were also available like Royal Nepal Airlines corporation, Nepal Rastra Bank, Nepal Industrial Development Corporation, Nepal Electricity Authority etc., or under the Corporation Act like Nepal Food Corporation, Nepal Transport Corporation, Agriculture Input Corporation etc. The continued effectiveness of such incorporations was implicitly recognized by prohibiting partnerships of more than twenty persons. This can be complied with by registration under the Companies Act but also by incorporation in pursuance of some other Act of Parliament.

In the past in Great Britain, statutory incorporation by private Acts of public utilities, such as railways, gas, water and electricity undertakings, was comparatively common since the undertakings would require powers and monopolistic rights which needed a special legislative grant. During the nineteenth century, therefore, public general Acts were passed providing for

standard clauses deemed to be incorporated into the private Acts, unless expressly excluded. As a result of post-war nationalization measures, most of these statutory companies were taken over by public boards or corporations set up by public Acts (but many, if not most, of them have now been 'privatized' and become registered companies). But some statutory companies remain and others may be formed.

Statutory companies are not created by registration under the Companies Act. Unless express provision is made to the contrary, the provisions of the Companies Act shall not apply to such companies. For example: Banking & Financial Institutions Act makes provisions that the Companies Act will apply to matters not mentioned in that Act, whereas the cooperative Act makes specifically that companies Act shall not apply to the cooperative societies.

2 CORPORATE PERSONALITY

(Note: In this study material, Companies Act, 2063 is simply referred to as the Act or Companies Act and the Indian and English Companies Act are specifically mentioned.)

The outstanding feature of a Company is its independent corporate existence. A partnership or **sole proprietorship** has no such existence apart from its owner. However, a Company, on the other hand, is a legal person. It is a distinct legal persona (personality) existing independent of its shareholders. One of the effect of incorporation is stated in Section 7(1) of the Companies Act, 2063. It says that a Company established under the Act shall be an autonomous body corporate having perpetual succession.

Independent Corporate Existence(Sec.7)

As stated above, the outstanding feature of a Company is its independent corporate existence. It is a distinct legal *persona* existing separate from its shareholders. One of the effect of incorporation is stated in Sec. 7(1) of the Companies Act. It says that a Company established under the Act shall be an autonomous *body corporate* having perpetual succession. The company acquires its own identity. No one can say that he is the owner of the Company and hence he shall be liable upon activities of his company. In the words ofPalmer: "The benefits following from incorporation can hardly be exaggerated. It is because of incorporation that the owner of the business ceases to trade in his own person. The company carries on the business, the liabilities are the company's liabilities and the former owner is under no liability for anything the company does, although, as principal shareholder, he is able to take full advantage of profits which the company makes".

A well-known illustration of this principle is the decision of the House of Lords in *Salomon v Salomon & Co.* (1895 – 99) All ER Rep 66. One Salomon was a boot and shoe manufacturer. His business was in sound condition and there was a substantial surplus of assets over liabilities. He incorporated a company named, Salomon & Co. Ltd., for the purpose of taking over the carrying on his business. The seven subscribers to the memorandum were Salomon, his wife, his daughter and four sons and they remained the only members of the company. Salomon, and two of his sons, constituted the board of directors of the company. The business was transferred to the company for £40,000. In payment, Salomon took 20,000 shares of £1 each and debentures

worth £10,000. These debentures certified that the company owed Salomon £10,000 and created a charge on the company's assets. One share was given to each remaining member of his family. The company went into liquidation within a year.

On winding up, the state of affairs was broadly something like this: Assets £6,000; Liabilities – Salomon as debenture holder: £10,000 and unsecured creditors: £7,000. Thus after paying off the debenture holder nothing would be left for the unsecured creditors. The unsecured creditors, therefore, contended that, though incorporated under the Act, the company never had an independent existence; it was in fact Salomon under another name; he was the managing director, the other directors being his sons and under his control. His vast preponderance of shares made him absolute master. The business was solely his, conducted solely for and by him and the company was a mere sham and fraud, in effect entirely contrary to the intent and meaning of the Companies Act. But it was held that Salomon & Co. Ltd. was a real company fulfilling all the legal requirements. It must be treated as a company, as an entity consisting of certain corporators, but a distinct and independent corporation. Their Lordships of the House of Lords observed:

"When the memorandum is duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate capable forthwith of exercising all the functions of an incorporated company. It is difficult to understand how a body corporate thus created by statute can lose its individuality by issuing the bulk of its capital to one person. The company is at law a different person altogether from the subscribers of the memorandum; and though it may be that after incorporation the business is precisely the same as before, the same persons are mangers, and the same hands receive the profits, the company is not in law their agent or trustee. The statute enacts nothing as to the extent or degree of interest which may be held by each of the seven or as to the proportion of interest, or influence possessed by one or majority of the shareholders over others. There is nothing in the Act requiring that the subscribers to the memorandum should be independent or unconnected, or that they or any of them should take a substantial interest in the undertaking, or that they should have a mind or will of their own, or that there should be anything like a balance of power in the constitution of the company".

This Principle had been recognized in India even before the Salomon case. The decision of the Calcutta High Court in *Kondoli Tea Co Ltd, Re,* [(1886) ILR:13 Cal: 43] seems to be the first on the subject.

Certain persons transferred a tea estate to a company and claimed exemptions *from ad valorem* stamp duty on transfer of the tea estate to the company on the ground that they themselves were the shareholders in the company and, therefore, it was nothing but a transfer from them in one to themselves under another name.

Rejecting this, the Court observed: "The Company was a separate person, a separate body altogether from the shareholders and the transfer was as much a conveyance, a transfer of the property, as if the shareholders had been totally different persons".

In reference to one-man companies of the *Salomon* type, the Bombay High Court [TR Pratt (Bombay) Ltd. v ED Sasson & Co. Ltd. AIR: 1936 Bom.62] observed: "Under the law, an incorporated company is a distinct entity, and although all the shares may be practically controlled by one person, in law a company is a distinct entity and it is not permissible or relevant to enquire whether the directors belonged to the same family or whether it is, as compendiously described a one-man company",

Thus one-man companies exist with the encouragement of the Legislature, and "the great majority of them are as *bona fide* and genuine as in a business sense they are convenient and suitable media for provision and application of capital to industry".

In *Dhulia-Amalner Motor Transport Ltd. v R. R. Dharamsi (AIR 1952 Bom 337):*A partnership firm carrying on the business of plying buses having worked for some time, some of the partners formed a private limited company, which they could do under the law even while the partnership continued to be a running concern. Such of the partners who formed the company sold to the company their own buses which were heretofore being used by the firm. The other set of partners who constituted the minority sued the section forming the company for accounts and their share of profits on the ground that in reality the company was not a different entity from the firm and that the business carried on by it was the same as that of the firm.

It was held that the plaintiffs had no legal right to sue for accounts of the business done by the company which was altogether a third person. Buses which the company was plying were the property not of its shareholders, but the property of the company itself. The company was a corporate body whose entity was entirely different from the entities of its shareholders. Motive for becoming shareholders is not a field of enquiry. The law recognizes the existence of the company quite irrespective of the motives, intentions, schemes, or conduct of the individual shareholders.

But now the Company Act, 2063, provides separate chapter for single shareholder Company.

Limited Liability

The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the commercial prosperity of the country. They have, to the advantage of the investor as well as of the public, allowed and encouraged aggregation of small sums into large capitals which have been employed in undertakings of great public utility largely increasing the wealth of the country.

One of the primary and accepted motivations behind incorporating a company is to limit personal risks by obtaining the benefit of limited liability. Sec.8 of the Companies Act provide for the sameas the liability of a shareholder of a company incorporated under this Act in respect of its transactions shall be limited to the maximum value of shares which he has subscribed or undertaken to subscribe**.**

Perpetual Succession

Company is an entity with perpetual succession. In company law, **perpetual succession** is the continuation of a company's existence despite the death, bankruptcy, insanity, change in shareholding or an exit from the business of any shareholder or member, or any transfer of share etc.

A, B and C are the only shareholders of a company, holding all its shares. Their shares may be transferred to, or inherited by X, Y and Z, who may, therefore, become the new shareholders and managers of the company. But the company will remain the same entity. In spite of the total change in shareholding, ―the Company will be the same entity, with the same privileges and immunities, estates, and possessions‖. Perpetual succession, therefore, means that the shareholding or membership of a company may keep changing from time to time, but that does not affect the company's continuity, "in the like manner as the river Thames is still the same river, though the parts which compose it are changing every instant‖. The death or insolvency of individual shareholder does not, in any way, affect the corporate existence of the company. "Shareholdersmay come and go but the company can go on forever".

Separate Property

A company, being a legal person, is capable of owning, enjoying and disposing of property in its own name. The company becomes the owner of its capital and assets. The shareholders are not the several or joint owners of the company's property. The company is thelegal person in which all its property is vested, and by which it is controlled, managed and disposed of. A member does not even have an insurable interest in the property of the company. A person was the holder of nearly all the shares, except one, of a timber company and was also a substantial creditor. He insured the company's timber in his own name. The timber having been destroyed by fire, the insurance company was held not liable to him (Macaura v Northern Assurance Co. Ltd. 1925AC619HL). No shareholder has any right to any item or property owned by the company, for he has no legal or equitable interest there in‖. "In WALTON J's simple truism: 'The property of the company is not the property of the shareholders; it is the property of the company'.

On the nationalization of the coal mines of a company, it was found that it had sold an item of its immovable property to the wife of one of its directors. The Court ripped open the veil to probe into the genuineness of the transaction and discovered its shamness. The property continued to be that of the company and became vested in the Government. The assets of a company were not allowed to be used for payment of a shareholder's debts. Unless a company's incorporation can be viewed as a sham, its property would fall outside the distribution of matrimonial assets on divorce. In a partnership, on the other hand, the distinction between the joint property of the firm and the private property of the partners is often not clear.

Transferable Shares

When joint stock companies were established, the great object was that their shares should be capable of being easily transferred. Accordingly, the Companies Act in Section 42 declares: "The shares or debentures or other interest of any shareholderin a company shall be movable property, transferable in the manner provided by the articles of association of the company". Thus

incorporation enables a shareholder to sell his shares in the open securities market and to get back his investment without having to withdraw the money from the company. This provides liquidity to the investor and stability to the company.

Capacity to Sue and be Sued

Section 7(3) of the Act provides:A company, being a body corporate, can sue and be sued in its own name. If any person harms right of the company, then the company may, as a plaintiff, sue against the concerned person for getting legal remedy. Likewise, if the company harms right of any other person or does not perform its duty, the other concerned person may sue against the company making it defendant in the case. Here, complaint may be filed by a company but it shall be represented by an authorized natural person. It is not necessary that the same person should act as a representative throughout. The complaint by a company is liable to be dismissed because of the absence of the representative in the same way in which an individual complaint is liable to be dismissed for absence of the complainant.

A company has the right to protect its fair name. It may sue for such defamatory remarks against it as are likely to damage its business or property etc. It may be defamatory to a company to allege that its directors allowed the company to continue trading at a time when it ought to have been facing insolvency. A company has a right to seek damages where a defamatory material published about it affects its business The Court of Appeal in England held that a company can complain under the Broadcasting Act 1996 about unwarranted infringement of its privacy. The Court said that a company may have activities of a private nature which need protection from unwarranted intrusion. Without such right the company would be disadvantaged as against individuals under a legislation which is designed to encourage and achieve proper standards of conduct in public life. The complaint was about the secret filming of transactions in shops by the BBC and the allegation was that this constituted an infringement of the company‘s privacy.

Professional Management

The corporate sector is capable of attracting the growing cadre of professional managers. Young management graduates willingly join companies because of the feeling that they would thereby belong to a managerial class. Their independent functioning as managers is assured because of the fact that there is no human employer and the shareholders exercise only a formative control. Prudent developments may be made, and new branches established in different places, and other concerns may be acquired. Thus, before very long a great business may be built up that is worthy and capable of absorbing the attention of such a competent manager, assisted by other directors working in harmony with him. Men of this caliber are not to be found every day, but, when found and supported by capital, they are capable of achieving the very highest success in commercial undertakings. Thus the stability of the company is maintained and preserved.

Finances

The company is the only medium of organizing business which is given the privilege of raising capital by public subscriptions either by way of shares or debentures. Further, public financial institutions lend their resources more willingly to companies than to other forms of business organization. The facility of borrowing and giving security by way of a floating charge is also an exclusive privilege of companies. “Capital in many cases is the life-blood of a concern, and it is

always a great misfortune where the development of a business is arrested or restricted by want of capital".

Lifting the Corporate Veil

The chief advantage of incorporation from which all others follow is the separate legal entity of the company. In reality, however, the business of the legal person is always carried on by, and for the benefit of, some individuals. In the ultimate analysis, some human beings are the real beneficiaries of the corporate advantages, "for a while, by fiction of law, a corporation is a distinct entity, yet in reality it is an association of persons who are in fact the beneficial owners of all the corporate property". [Gallaghar v Germania Brewing Co. (1893) 53].

This theory of corporate entity is indeed the basic principle on which the whole law of corporations is based. Instances are many in which the courts have successfully resisted the temptation to break through the corporate veil. A landlady's bid to regain tenanted premises for self-business could not succeed as the business was in the name of her company (*Basheer v Lona Chackola*). The Supreme Court should not allow a shareholder to sue for the violation of the fundamental rights of his company (Chiranjit Lal v UOI, 1950 SCR 869). Where a company acquires a majority of the shares and also the assets of another company that does not extinguish the debt of one to the other. (*Spencer & Co v CWT, AIR 1969 Mad 359*). The shareholders and creditors of a dissolved company cannot maintain an action for the recovery of its left-over assets (*P. Leslie & Co. v V.O. Wapshare, AIR 1969 SC 843)*. A managing director cannot be compelled in his personal capacity to produce books of which he has custody in official capacity [*S.A.K.Chinnathambi v Murgugar, (1968)*]. In *Lee v Lee's Air Farming Ltd,* Lee incorporated a company of which he was the managing director. In that capacity he appointed himself as a pilot of the company. While on the business of the company he was lost in a flying accident. His widow recovered compensation under the Workmen's Compensation Act. "In effect the magic of corporate personality enabled him to be master and servant at the same time". Where the total number of directors and shareholders consent to the misuse of the company's money, they can be prosecuted for theft because the consent of the whole number may not be the consent of the company.

But the theory cannot be pushed to unnatural limits. Circumstances must occur which compel the courts to identify a company with its shareholders. "There are situations where the court will lift the veil of incorporation in order to examine the 'realities'which lay behind.

The doctrine of lifting the veil plays a small role in British company law except where it is required under a statute or contract. This is in contrast to the law in United States where the veil is lifted more readily. However, even in the United States Courts have never lifted the veil in the case of a public company and even in case of private companies routinely, except for inadequate capitalization.

The corporate veil is said to be lifted when the court ignores the company and concerns itself directly with the shareholders or managers. The matter is largely in the discretion of the courts and will depend upon the under lying social, economic and moral factors as they

operate in and through the corporation. The following grounds have become well-established:

a) Determination of Character

Occasionally it becomes necessary to determine the character of a company, for example, to see whether it is 'enemy'. In such a case, the courts may in their discretion examine the character of persons in real control of the corporate affairs. *Daimler Co. Ltd. v Continental Tyre & Rubber Co. Ltd.* illustrative: A company was incorporated in England for the purpose of selling tires manufactured in Germany by a German company. The German company held the bulk of the shares in the English company. The holders of the remaining shares (except one) and all the directors were Germans, resident in Germany. Thus the real control of the English company was in German hands. During the First War the English company commenced an action to recover a trade debt. And the question was whether the company had become an enemy company and should, therefore, be barred from maintaining the action.

The House of Lords laid down that a company incorporated in the United Kingdom is a legal entity, a creation of law with the status and capacity which the law confers. It is not a natural person with mind of conscience. It can be neither loyal nor disloyal. It can be neither friend nor enemy. But it may assume an enemy character when persons in *de facto* control of its affairs are residents in any enemy country or, wherever resident, are acting under the control of enemies. Accordingly the company was not allowed to proceed with the action.

But where there is no such danger to public interest, the courts may refuse to tear open the corporate veil.

b) For Benefit of General Revenue

"The Court has the power to disregard corporate entity if it is used for tax evasion or to circumvent tax obligation". A clear illustration is *Dinshaw Maneckjee Petit, Re: AIR 1927 Bom 371.* The assessee was a wealthy man enjoying huge dividend and interest income. He formed four private companies and agreed with each to hold a block of investments as an agent for it. Income received was credited in the accounts of the company but the company handed back the amount to him as a pretended loan. This way he divided his income into four parts in a bid to reduce his tax liability.

But it was held that, "the company was formed by the assessee purely and simply as a means of avoiding super-tax and the company was nothing more than the assessee himself. It did not do any business, but was created simply as a legal entity to ostensibly receive the dividends and interests and to hand them over to the assessee as pretended loans".

The leading English authority is *Apthorpe v Peter Schoenhofen Brewing Co.* Aliens were not allowed to hold land in New York. An English company acquired the business and assets of a New York company. But the American company was kept on foot to hold the land. The business was financed and run by the English company.

It was held that the American company had become the agent of the English company and therefore, the whole of its profits were liable to be taxed as the income of the English company.

Members themselves, however, are not allowed to claim that they should be regarded as economically identical with the company, particularly when this is not in the interest of revenue. In *Bacha F. Guzdar v CIT. Bombay:*

Under the Income tax Act, then in force, agricultural income was exempt from tax. The income of a tea company was exempt up to 60% as agricultural income and 40% was taxed as income from manufacture and sale of tea. The plaintiff was a member of a tea company. She received a certain amount as dividend in respect of shares held by her in the company and claimed that this dividend income should be regarded as agricultural income up to 60%.

But it was held that although the income in the hands of the company was partly agricultural, yet the same income when received by the shareholders as dividends could not be regarded as agricultural income.

Another attempt by the members of a company to treat themselves at par with the company was frustrated by the Calcutta High Court in *CIT v Associated Clothiers Ltd.* The assessee, Associated Clothiers, formed a company holding all its shares. They sold certain premises to the new company. The difference between the selling price and the cost of the property in the hands of assesses was assessed as their income.They contended that this could not be done as there was no commercial sale, but only a transfer from self to self. The court rejected this and held that it was sale from one entity to another and not a trading with oneself.

c) Fraud or Improper Conduct

The corporate entity is wholly incapable of being strained to an illegal or fraudulent purpose. The courts will refuse to uphold the separate existence of the company where it is formed to defeat or circumvent law, to defraud creditors or to avoid legal obligations. One clear illustration is *Gilford Motor Co. v Horne* [(1993) 1 Ch935]. Horne was appointed as a managing director of the plaintiff company on the condition that "he shall not at any time while he shall hold the office of a managing director or afterwards, solicit or entice away the customers of the company". His employment was determined under an agreement. Shortly afterwards he opened a business in the name of a company which solicited the plaintiff's customers.

It was held that "the company was a mere cloak or sham for the purpose of enabling the defendant to commit a breach of his covenant against solicitation. Evidence as to the formation of the company and as to the position of its shareholders and directors, lead to that inference. The defendant company was a mere channel used by the defendant Home for the purpose of enabling him, for his own benefit, to obtain the advantage of the customers of the plaintiff company, and that the defendant company ought to be restrained as well as the defendant Home".

Where a person borrowed money from a company and invested it in shares of three different companies in all of which he and his son were the only members, the lending company was

permitted to attach the assets of such companies as they were created only to hoodwink the lending company [*PNB Finance v Shital Pd Jain, (1983)]*. Where a company created a subsidiary and transferred its investment holdings to it in a bid to reduce its liability to pay bonus to its workers, the Supreme Court of India brushed aside the separate existence of the subsidiary company. "It is the dutyof the court, in every case where in genuity is expended to avoid taxing and welfare legislation, to get behind the smoke screen and discover the true state of affairs" [Workmen v Associated Rubber Industry Ltd, (1985) 4 SCC 114]. The following statement in the judgment of CHINNAPPA REDDY J shows how the court guessed that evasion was the only purpose:

A new company is created, wholly owned by the principal company, with no assets of its own except those transferred to it by the principal company, with no business or income of its own except receiving dividends from share transferred to it by the principal company and serving no purpose whatsoever except to reduce the gross profits of the principal company. These facts speak for themselves. There cannot be direct evidence that the second company was formed as a device to reduce the gross profits of the principal company for whatever purpose. An obvious purpose that it served and which stares one in the face is to reduce the amount to be paid by way of bonus to workmen.

This finding was further supported by the fact that the subsidiary was subsequently wound up and amalgamated into the holding company.

A controlling shareholder commenced action against a company for recovery of a loan supposed to have been made by his company to the debtor company. The alleged loan agreement pre-dated the incorporation of the lending company. The action was, therefore, dismissed. Subsequent to this company commenced an action on the basis of a written loan agreement. This action was dismissed under the principle of *res judicata*. The company was wholly owned and controlled by one person and might have started the action at his behest [*Barakot Ltd. v Epiettee Ltd*, (1997) 1 BCLC 303 QBD.

d) Government Companies

A company may sometimes be regarded as an agent or trustee of its shareholders of another company and may, therefore, be deemed to have lost its individuality in favor of its principal. In India this question has frequently arisen in connection with Government companies. A large number of private companies for commercial purposes have been registered under the Company Act with the President and a few other officers as the shareholders. The obvious advantage of forming a Government company is that it gives the activities of the State "a little of the freedom which was enjoyed by private corporations and [the Government] escaped the rules and principles which hampered action when it was done by a Government department instead of a Government corporation. In other words, it gave the Government some of the robes of the individual". And in order to assure this freedom the Supreme Court pf India has reiterated in a number of cases that a Government company is not a department or an extension of the State [*State Trading Corpn. of India Ltd v CTO,* AIR 1963 SC 1811]. It is not an agent of the State. Accordingly, its employees are not civil servants [*Praga Tools Corpnv Immanuel* ,(1969) 1 SCC 585: AIR 1969 SC 1306] and prerogative writs cannot issue against it [*Heavy Engng Mazdoor*

Union v State of Bihar, (1969) 1 SCC 765]. In one of these cases, the court remarked: "The Company being a non-statutory body and one incorporated under the Companies Act there was neither a statutory nor a public duty imposed on it by a statute in respect of which enforcement could be sought by means of a mandamus".

A Government company will be regarded as an agent of the State only when it is performing in substance governmental or sovereign and not merely commercial functions [*Tamlinv Hannaford,* (1950)1KB18,25:(1949)2 All ER 327 CA].

The case before the Supreme Court was *Som Prakash Rekhi v UOI* [(1981) 1 SCC 449: (1981) 51 Comp Cas 71]. The company in question arose out of the acquisition and vesting in the Central Government of the assets and business of Burmah Shell. The employee, who had certain rights as to provident fund etc., against the former company, claimed them against the Government by means of writ. His claim was resisted on the ground that the undertaking had been vested in a company registered under the Companies Act and the question of a writ against a private company could not arise. KRISHNA IYER J brushed aside this contention. He laid emphasis upon the fact that the whole undertaking had been vested in the Central Government and, therefore, it became a State undertaking. The learned judge also stressed the fact that the law should not go by the fact whether the company is registered under the Companies Act or otherwise, but by the nature of the functions that the unit was performing. Here the statement of reasons stated that the company was being acquired in public interest and thus the new company was created to perform a function of public nature. The court noted the fact that the reason why the State chose to function through companies was not to frustrate employees, but to assure commercial flexibility and freedom from departmental rigidity, slow motion procedures and hierarchy of officers.

KRISHNA IYER J remarked: "If it is found to be a mere agent or surrogate of the State, in fact owned by the State, in truth controlled by the State and in effect an incarnation of the State, Constitutional lawyers must not blink at these facts and frustrate enforcement of fundamental rights despite the inclusive definition of Article 12 that any authority controlled by the Government of India is itself State".

An employee was allowed to proceed against a Government company under writ jurisdiction to question the termination of his services. [H. Purushotam v UOI, (1997) 14 SCR 191 Cal Mysore Papers Ltd v Mysore Paper Mills Officers Assn, (1999) 1 Comp LJ 88 Kant.] In Secy; Haryana SEBv Suresh, [(1999) 3 SCC 601: AIR 1999 SC 1160,] the Supreme Court observed that although the doctrine of not "lifting of the veil", asenunciated in Salomoncase, came to be recognized in the corporate jurisprudence but its inapplicability in the present context cannot be doubted, since the law court invariably has to rise up to the occasion to do justice between the parties in a manner as it deems fit. In Kapila Hingorani v State of Bihar, (2003) 116 Comp Cas 133 SC, the Government was not allowed to shelter behind the lack of resources in discharging its obligation to pay wages of the employees of a Government company.

e) Agency or Trust, Where no Functioning Autonomy Granted

If one company is to be fixed with liability as a principal for the acts of another company, the relationship of agency should be substantively established. The facts of *Smith, Stone & Knight Ltd v Birmingham Corporation* [(1939) 4 All 116 KB. A similar claim has again been upheld in *DHN Food Distributors Ltd v Tower Hamlets London Borough Council*, (1976) 1 WLR 852] revealed a relationship of this kind. A company acquired a partnership concern, registered it as a company, and then continued to carry it on as a subsidiary company. The parent company held all the shares except a few, treated the subsidiary's profits as its own, appointed managers and exercised effectual and constant control. When the business of the subsidiary was acquired by the defendant corporation the court allowed the parent company, brushing aside the legal distinction between the two companies, to claim compensation in respect of removal and disturbance. The subsidiary company was not operative on its own behalf, but on behalf of the parent company. *ATKINSON J* first noted the rule that "it is well settled that the mere fact that a man holds all the shares in a company does not make the business carried on by that company his business. It is also well settled that there may by such an arrangement between the shareholders and a company as will constitute the company the shareholders 'agent for the purpose of carrying on the business and make it the business of the shareholders". The learned judge then referred to six points which are useful for ascertaining who really was carrying on the business. The first point was: Were the profits treated as the profits of the parent company? Secondly, were the persons conducting the business appointed by the parent company? Thirdly, was the company the head and the brain of the trading company? Fourthly, did the company govern the adventure; decide what should be done and what capital should be embarked on the venture? Fifthly, did the company make the profit by its skill and direction? Was the company in constant and effectual control? After considering the answer to these questions the learned judge concluded that if ever one company could be said to be the agent or employee, or tool or *simulacrum* of another that was the case here. [This formula was cited in *Dy Commr. IT v Cheran Transport Corpn Ltd.* (1992) 74 Comp Cas 563 Mad, for the guidance of the IT authorities as to when they can club the income of certain companies together for a single assessment].

This exclusive control in all respects and without any other person having any voice in the affairs is the surest indication of agency or trust. The following statement of Lord DENNING, MR pictorially portrays the circumstances in which a company is nothing but the controller himself under another hat [*Wallersteiner v Moir,* (1974) 1 WLR 991: (1974) 1 All ER 217 CA]. "It is plain that W used many companies, trusts, or other legal entities as if they belonged to him. He was in control of them as much as any "One-man company" is under the control of one who owns all the shares and is the chairman and managing director. He made contracts of enormous magnitude on their behalf on a sheet of note paper without reference to anyone else. I am prepared to accept that the companies were distinct legal entities even so they were just the puppets of W. He controlled their every movement. Each danced to his bidding. He pulled the strings. No one else got within the reach of them. Transformed into legal language, they were his agents to do as he commanded. He was the principal behind them. I am of the opinion that the court should put aside the corporate veil and treat these concerns as being his creatures for whose doings he should be, and is, responsible".

For purposes of taxation also the same tests are applicable to see whether a company is not an agent or trustee of another. Lord DENNIGN MR said in a case [*Littlewoods Mail Order Stores Ltd v IRC*, (1969) 3 All ER 855 CA: (1969) 1 WLR 1241]. "The doctrine laid down in *Salomon v Salomon & Co* has to be watched very carefully. It has often been supposed to cast a veil over the personality of a limited company through which the courts cannot see. But that is not true. The courts can and often do draw aside the veil. They can, and often do, pull off the mask. They look to see what really lies behind. The legislature has shown the way with group accounts and the rest. And the courts should also follow suit. We should look at the Fork Company and see it as it really is – the wholly owned subsidiary of the tax-payers. It is the creature, the puppet of the tax-payers in point of fact, and it should be so regarded in point of law".

Another illustration is *F. G.; (Films) Ltd, Re* [(1993) 1 WLR 483]. An American company produced a film called 'Monsoon' in India technically in the name of a company incorporated in England. The English company had a capital of £100 in £1 shares, 90 of which were held by an American director. The production was financed by the American company. In these circumstances the Board of Trade refused to register it as a British film and their decision was upheld by the court. It would be a mere travesty of the facts to say or to believe that this insignificant company undertook the arrangements for the making of the film. They acted, in so far as they acted at all in the matter, merely as the nominee of, and agent for the American company and hence not entitled to the subsidy which a British company enjoyed.

Personal Liability of Directors and Shareholders: Statutory provisions

The Act also imposes personal liability on the directors or shareholders of a company in certain cases. Independent existence of the company is maintained and the company may also be liable. But, apart from the liability of the company, those cloaked behind it are also made liable. Following are some such provisions of the Act:

(a) Reduction in Membership

Section 45 of the Indian Companies Act provides: If at any time the number of members of a company is reduced, in the case of a public company, below seven, or in the case of a private company, below two and the company carried on business for more than six months while the number is so reduced, every person who is a member of company and is cognizant of the fact shall be severally liable for the payment of the whole debts of the company contracted during that time.

But Sec. 14 of Companies Act, 2063 provides that if the number of shareholders of a public company goes below seven, it shall be converted into a private company. In such a case, the company shallmake necessary amendments to its memorandum of association and articles of association and convert it into a private company within six months.

A shareholder of a company became liable severally and jointly with the company for the debts incurred during the period when he was the sole shareholder of the company. He had himself purchased the shares of the only other shareholder of the company [*Nisbet v Shepherd*, (1994) BCLC 300: (1995) 19 Corpt LA 234 CA] HOFFMAN J observed: "I have considerable

sympathy with the appellant, who has fall enintoa trap created by an ancient and obsolete rule. Section 24 of the [English] Companies Act, 1985 requires that a company should have at least two members. In default of compliance it strips the remaining member of the protection of limited liability. The rule goes back to Section 48 of the [English] Companies Act, 1862 when the minimum number of members was seven. This reflects the evolution of company law from partnership, but the reason why it has survived through successive Companies Act is obscure. It seems to serve no purpose in protecting the public or anyone else. It is not necessary that the second member should hold his share or shares beneficially. The appellant could have satisfied the requirement of the Act transferring a single share to his wife, lawyer or accountant to hold in trust for himself. But did none of these things. Since 1983, the appellant has been the sole member and is liable accordingly".

All the remaining members would have to be impleaded as necessary parties, even if the circumstances are such that some of them would not be severally liable [*Madanlal v Himatlal*, (1997) 1 Comp LJ 399: (2000) 37 CLA 273 MP].

(b) Misdescription of Name

Secondly, where in any act or contract of a company, its name is not fully or properly indicated as required by Section of the English Act, those who have actually done the act or made the contract shall be personally liable for it. Thus the directors were held personally liable on a cheque signed by them in the name of a company stating the company's name as "L R Agencies Ltd", the realnamebeing "L & R Agencies Ltd" [*Hendonv Adelman, Thetimes, June16, 1973: 1973 New LJ637]*.

(c) Fraudulent Conduct of Business

Section 542 of English Companies Act imposes liability for fraudulent conduct of a company's business. According to the section, "if in the course of winding up of a company, it appears that any business of the company has been carried on with intent to defraud creditors of the company or any other persons, or for any fraudulent purpose‖, those who were knowingly parties to such conduct of business may, in the discretion of the Tribunal, be made personally liable for all or any of the debts of the company [*Willian C. Leitch Bros Ltd, Re*, (1932) 2 Ch 71: (1932) All ER Rep 892. Nigel L. Mecassey, *Responsibility for Fraudulent Trading*, 1973 New LJ 822]. Similar provision is made in Sec. 134 of the Companies Act making the Director, the Managing Director and other officers personally liable for any acts of deceit or fraud committed against the company.

(d) Holding and Subsidiary Companies [Sec. 2 (d) &(e)]

The Court may, on facts of a case, refuse to grant a subsidiary company an independent status. "It may not be possible to put in a straitjacket of judicial definition as to when the subsidiary company can really be treated as a branch, or an agent, or a trustee of the holding company. Circumstances such as the profits of the subsidiary company being treated as those of the parent company, the control and conduct of business of the subsidiary company resting completely in the nominees of the holding company may indicate that in fact the subsidiary company is only a branch of the holding company" [KAPUR J in Freewheels (India) Ltd v Dr Veda Mitra, AIR

1969 Del 258]. That result followed in the case of a wholly owned subsidiary whose parent company was allowed to recover compensation when the land of its subsidiary on which it was carrying on business was acquired [*DHN Food Distributors Ltd v Tower Hamlets London Borough Council, (1976) 1 WLR 852]*. A change of majority shareholding between two companies associated with each other being the subsidiaries of the same company, did not have the effect of enabling the statutory tenants of the company's flats to say that the landlord had changed [*Michaels v Harley House (Marylebone) Ltd, (1999)* 1 ALL ER 356(CA)].

(e) Liability for Insolvent Subsidiary

The question whether the parent company should be held liable for the debts of its insolvent subsidiary involves a difficult problem. The difficulty has been indicated in a case which exposes the legal inadequacy and which has been thus presented [*Southard & Co Ltd, Re,* 91979) 1 WLR 1198, 1208, TEMPLETON LJ, 1908 JBL 160].

English company law possesses some curious features, which may generate various results. A parent company may spawn a number of subsidiary companies, all controlled directly or indirectly by the shareholders of the parent company. If one of the subsidiary companies turns out to be the runt of the litter and declines into insolvency to the dismay of its creditors, the parent company and the other subsidiary companies may prosper to the joy of the shareholders without any liability for the debts of the insolvent subsidiary. It is not surprising that when a subsidiary collapses, the unsecured creditors wish the finances of the company and its relationship with other members of the group to be narrowly examined, to ensure that no assets of the subsidiary company have leaked away; that no liabilities of the subsidiary company ought to be laid at the door of the other members of the group and that no indemnity from or right of action against any other company, or against any individual is by some mischief over looked.

Conclusion

Thus, it is abundantly clear that incorporation does not cut off personal liability at all times and in all circumstances [Clive M. Schmitthoff, Salomon in the Shadow, 1976 JBL 305, where the learned writer says that if it were otherwise Salomon would have been misunderstood] ."Honest enterprise, by means of companies is allowed; but the public are protected against kiting and humbuggery" [Cadman, THE CORPORATIONIN NEW JERSEY, 353(1949)]. 'The sanctity of a separate corporate identity is upheld only in so far as the entity is consonant with the underlying policies which give it life' [*Mull v Colt Co,* 31 FRD (1962), quoted in W. Friedman, LEGAL THEORY, 564 (5^{th} Edn, 1967)]. Those who enjoy the benefits of the machinery of incorporation have to assure a capital structure adequate to the size of the enterprise. They must not withdraw the corporate assets or mingle their own individual accounts with those of the corporation or represent to third parties that no difference exists between themselves and the company. The courts have at times seized upon these facts as evidence to justify the imposition of liability upon the shareholders".

Company is Not Citizen

Lastly, it may be added that a company, though a legal person, is not a citizen either under the Constitution or under the Citizenship Act. This has been the conclusion of a special bench of the

Supreme Court of India in *State Trading Corpn of India Ltd vCTO*. "The State Trading Corporation of India is incorporated as a private company under the Companies Act. All the shares are held by the President of India and two secretaries in their official capacities. The question was whether the corporation was a citizen. One of the contentions put forth on behalf of the corporation was that if the corporate veil is pierced one sees three persons who are admittedly the citizens of India, and, therefore, the corporation should also be regarded as acitizen".

But it was held that "neither the provisions of the Constitution, Part II, nor of the Citizenship Act, either confer the right of citizenship on, or recognize as citizen, any person other than a natural person". In the striking words of HIDAYATUALLAH J (afterwards CJ): "If all of them (the members) are citizens of India the company does not become a citizen of India any more than, if all are married the company would be a married person".

A company is, however, a person in the eyes of law and it can claim the protection of such fundamental rights as are guaranteed to all persons whether citizens or not. A company cannot claim the protection of such fundamental rights as are expressly guaranteed to citizens only.

Nationality, Domicile and Residence of Company

A company does, however, have a nationality, domicile and residence. Speaking of this MACNAGHTEN J laid down: [See *State of Gujarat v Shri Ambica Mills Ltd.* (1974) 4 SCC 656; *Neptune Assurance Co v UOI*, (1973) 1 SCC 310,335: 43 Comp Cas 469, and the *Bank Nationalization case*, (1970) 1 SCC 248: (1970) 40 Comp Cas 325]. "It was suggested that a body corporate has no domicile. It is quite true that a body corporate cannot have a domicile in the same sense as an individual. But by analogy with a natural person, the attributes of residence, domicile and nationality can be given to a body corporate".

A company incorporated in a particular country has the nationality of that country, though, unlike a natural person, it cannot change its nationality [*Kuenigl v Donnersmarck*, (1955) 1 QB 515, 535: [1955] 1 All ER46].

The same principles apply to the determination of the residence of a company. Lord LOREBURN stated in a case before the House of Lords [*De Beers Consolidated Mines v Howe*, 1906 AC 455] that in applying the concept of residence to a company we ought to proceed as nearly as we can upon the analogy of an individual. "A company cannot eat or sleep, but it can keep house and do business. We ought, therefore, to see where it really keeps house and does business. An individual may be of a foreign nationality and yet reside in the United Kingdom, so may a company. Otherwise it might have its chief seat of management and its center of trading in England under the protection of English laws, and yet escape the appropriate taxation by the simple expedient of being registered abroad and distributing its dividends abroad. A company resides for purposes of income tax where its real business is carried on. The real business is carried on where the central management and control actually resides".

3 INCORPORATION OF COMPANY

Procedure of Incorporation [Sec.4]

1) Any person desirous of incorporating a company shall make an online application to the Office of Company Registrar) for the approval of proposed name of the company.
2) After receiving information of approval of name of the company as above, the applicant shall make an application to the Office in the format as prescribed along with the following documents uploaded in the computer system through electronic medium:
   a) Memorandum of Association of the proposed company
   b) Articles of Association of the proposed company,
   c) In the case of a public company, a copy of the agreement, if any, entered into between the promoters prior to the incorporation of the company,
   d) In the case of a private company, a copy of the consensus agreement, if any, entered into for the internal management of the company, structure of the Board of Director (i.e. order of becoming chairperson the BoD) etc.,

The above are the normal requirements to incorporate a company in other countrie*s as well* But to do business, wherever it requires to obtain any license, then it can do business only after obtaining the necessary approval or licenses.

Thus, Sec. 4 of the Act provides for the following additional formalities to be completed in the following cases:

Circumstances	Formalities
In cases where any company for undertaking any particular business requires prior permission or license under the laws of Nepal	Prior permission or license certificate should be submitted (eg. prior permis*sion of NRB for incorporating a commercial bank)*
If the promoter is Nepali citizens	Certified copy of citizenship certificate.
If any of the promoter is a corporate body	Board resolution of that Company to be the promoter of the new Company and authorization for the person to sign the memorandum and application on behalf of the company and any other important documents relating to such company i.e. certified copy of certificate of incorporation, Memorandum of Association and Articles of Association.
If a foreigner or Company or body corporate is the promoter	Permission obtained to invest or do business in accordance with the laws of Nepal.
If the promoters is a foreign citizen	Documents to prove the citizenship of the country to which he belongs.

If the promoter is a foreign company or body corporate	(a) Certified copy of its certificate of incorporation of that company and other important documents relating to its incorporation. (b) Certificate copy of deci*sion* to invest in Nepal from the Board or other authorized person of the company. (c) Credibility certificate from the banker of the promoter in his country Note: If these documents are in a language other than English, then a certified copies of these documents translated into English shall be submitted.

Section 5 of the Act states the issuance of registration certificate of a company, and Sec. 9 enables minimum seven promoters for incorporating a public company and minimum one promoter for a private company They can do so by subscribing shares at their names in a memorandum of association& article of association and by complying with other requirements. However, a public company desiring to incorporate another new public company need not have seven promoters and the public company as a single promoter may incorporate a new public company.

The amendment in Section 9 has introduced new sub-section (1a). The new provision has been made effective from 2075/11/19.It provides, if the transportation entrepreneurs associated with Transportation Entrepreneurs Committee registered pursuant to the prevailing laws, wish to incorporate a private company through themselves to carry on transportation business, they shall be required to submit application within 3 months of commencement of this sub-section. If the application for registration of company is submitted within 3 months, the private company shall be incorporated despite the number of shareholders exceed 101.

When the requisite documents are presented for incorporation of a company, the Office of Company Registrar has to see whether they answer the requirements of the Act. He may, however, accept the declaration as sufficient evidence of compliance. He then registers the company under Sec. 5 and places the name of the company in the Register of Companies [Refusal to register on a ground which is not legitimate can be set right by a court order, e.g. refusal on the enquiry into the motives on future plans of promoters. *Exclusive Board of the Methodist Church v UOI,* (1985) 57 Comp Cas 43 Bom]. A certificate of incorporation is then issued by the Registrar which certifies under his hand that the company is in corporated and, that the company is limited.

Certificate of Incorporation [Sec. 34 of Indian Companies Act]

The certificate of incorporation brings the company into existence as a legal person. Upon its issue the company is born. For the Act provides that "from the date of incorporation such of the subscribers of the memorandum and other persons, as may from time to time be the members of the company, shall be a body corporate, capable forthwith of exercising all the functions of an

incorporated company" [S. 34(2)]. The company's life commences from the date mentioned in the certificate of incorporation and the date appearing on it is conclusive, even if wrong.

(a) Certificate as Conclusive Evidence

Not only does the certificate create the company. It also is "the conclusive evidence that all the requirements of this Act have been complied with in respect of registration and matters precedent and incidental thereto and that the association is a company authorized to be registered and duly registered under this Act" [S. 35of Indian Companies Act]. In other words, the validity of the certificate cannot be disputed on any grounds whatsoever. This is illustrated by the decision of the Judicial Committee of the Privy Council in *Moosa Goolam Ariff v Ebrahim Goolam Ariff [ILR (1913) 40 Cal 1PC]*.

The memorandum of association of a company was signed by two adult persons and by a guardian of the other five members, who were minors at the time, the guardian making a separate signature for each of the minors. The Registrar, however, registered the company and issued under his hand a certificate of incorporation. The plaintiff contended that this certificate of incorporation should be declaredvoid. Lord MACNAGHTEN said: Their Lordships will assume that the conditions of registration prescribed by the Indian Companies Act were not duly complied with; that there were no seven subscribers to the memorandum and that the Registrar ought not to have granted the certificate. But the certificate is conclusive for all purposes.

In England the question whether the Registrar's certificate is conclusive was decided so far back as 1867 by Lord CAIRNS. In *Peel* case [(1867) 2 Ch App 674:16 LT 780] after signature and before registration a proposed memorandum of association had been altered without the authority of the subscribersso materially that the "alteration entirely neutralized and annihilated the original execution and signature of the document". The company, however, was registered and the Registrar gave his certificate of incorporation. It was objected that the memorandum of association had not been signed by seven or indeed by any subscribers and that the provisions of the Act had not been compliedwith.TothatpropositionLordCAIRNSassented.But"thecertificate ofincorporation",he said,"is not merely a *prime facie* answer,but a conclusive answer to such objection. When once the certificate of incorporation is given nothing is to be inquired into as to the regularity of the prior proceeding''. The observations of Lord CHELMSFORD in *Oakes v Turquand* [(1867) LR 2 HL 325. *See also Jubilee Cotton Mills v Lewis,* 1924 AC 958] are to the same effect. "I think", said his Lordship, "the certificate prevents all recurrence to prior matters essential to registration and that it is conclusive that all previous requisites have been complied with" [ILR (1913) 40 Cal 1 PC].

"Thus the position is firmly established that if a company is born, the only method to get it extinguished is not by assailing its incorporation, but by resorting to the provisions of enactments, which provide for the winding up of the companies". This summary view of the position is to be found in the judgment of CHANDRA REDDY CJ in *T.V Krishna v Andhra Prabha (P) Ltd.* "In this case the Express Newspapers (P) Ltd were the leading publishers of newspapers and weeklies. The Government adopted certain recommendations of the Wage Board for improvement in the terms of service and salaries of the working journalists. There upon the Express Newspapers sold its undertaking to a new company known as Andhra Prabha

Private Ltd. It was alleged that the new company was formed for the illegal purpose of evading the new responsibility imposed by the Wage Board and, therefore, the registration of the company should be declared void".

The Court, however, did not assent to the proposition that the purpose for which the company was formed was in any way unlawful or opposed to public policy and, therefore, held that company was validly incorporated. But even if some of the objects were illegal, the legal *persona* of the company could not have been extinguished by canceling the certificate. Even in such a case the certificate is conclusive and the remedy would be to wind up the company. The illegal objects, however, do not become legal by the issue of the certificate (*Universal Mutual Aid & Poor Houses Ass v A. D. Thappa Naidu,* AIR 1933 Mad 16.) Registrar can refuse to register a memorandum with unlawful objects and, if per chance, he happens to do so, his certificate is not conclusive as to lawfulness of objects. [*Performing Rights Society Ltd v London Theatre of Varieties,* (1992) KB 539; R v ROC, (1931) 2 KB 197]. Section 6(1)(b) clearly mentions that ROC can refuse to register a company if its objects are contrary to existing laws and public benefit or equity good conduct etc.

(b) Judicial Review

In some English cases, the courts have explored the possibility of reviewing the Registrar's certificates and have come to the conclusion that they should be open to judicial review. Accordingly, a company which happened to be registered for an unlawful object, was ordered to be struck off. This is so because a company cannot properly be registered for an unlawful purpose.

The Kerala High Court has held that a writ cannot be issued to cancel the registration of a company under the Companies Act [*Maluk Mohamed v Capital Stock Exchange Kerala Ltd,* (1991) 72 Com. Cas 333 Ker].

PRE- INCORPORATION CONTRACTS

(a) Company cannot be sued on Pre-incorporation Contract

As per section 17 of the Act, a contract made on behalf of a company prior to its incorporation shall be a proposed contract only for the company, not be binding or enforceable on the company. So, if prior to the incorporation of a company, any person carries on any transaction or borrows money on behalf of the company, such person shall be personally liable for any contract related with the transaction so carried on. It means, such pre incorporation contract is enforceable against particular person that made the contract not enforceable against the company. However, if, within the time mentioned in any transactions or within the reasonable time after the incorporation of a company, the company, through its act, action or conduct, accepts any act, action or conduct, accepts any act, action or borrowing done or made prior to the date of authorization to commence its transactions or endorses such act or action, that transaction shall be binding on the company and the other contracting party; and the person carrying out such act to action shall be released from the personal liability to be borne in the contract.

Notwithstanding anything contained elsewhere in this Section, the consensus agreement of a private company shall govern any contracts made prior to the incorporation of such company.

Sometimes contracts are made on behalf of a company even before it is duly incorporated. But no contract can bind a company before it becomes capable of contracting by incorporation. "Two consenting parties are necessary to a contract, whereas the company, before incorporation, is a non-entity" [*Erle CJ in Kelner v Baxter*, (1866) LR 2 CP 174: 15 LT 213: (1861-73) All ER Rep Ext 2009]. A company has no legal status prior to incorporation. It can have no income before incorporation for tax purposes [*CIT v City Mills Distributors (P) Ltd*, (1996) 2 SCC 375]. Shares cannot be acquired in the name of a company before its incorporation. A transfer form is liable to be rejected where the name of a proposed company is entered in the column of transferee [*Inlec Investment (P) Ltd v Dynamatic Hydraulics Ltd*, (1989) 3 Comp LJ221,225CLB]. Thus, for example: A solicitor, on the instructions of certain gentlemen, prepared the necessary documents and obtained the registration of a company. He paid the registration fee and incurred the incidental expenses of registration. "But the company was held not bound to pay for those services and expenses. The company could not be sued in law for those expenses, inasmuch as it was not in existence at the time when the expenses were incurred and ratification was impossible".

"It is not desirable to saddle the corporation with burdens imposed upon it in advance by overly optimistic promoters". [Joseph H. Gross, Pre-incorporation Contracts, (1971) 87 LQR 367, 368]

(b) Company Cannot Sue on Pre-incorporationContract

Secondly, the company is also not entitled to sue on a pre-incorporation contract. "A company cannot by adoption or ratification obtain the benefit of a contract purporting to have been made on its behalf before the company came into existence". This was held in *Natal Land & Colonisation Co v Pauline Colliery Syndicate* [89 LT 678: 1904 AC 120: (1900-03) All ER Rep Ext 1050].

N Co entered into an agreement with one C, who acted on behalf of a proposed syndicate. Under the agreement *N Co* was to give the syndicate a lease of coal mining rights. The syndicate was then registered and struck a seam of coal and claimed a lease which *N Co* refused. An action by the syndicate for specific performance of the agreement or in the alternative for damages held was not maintainable as the syndicate was not in existence when the contract was signed.

(c) Ratification of Pre-incorporation Contract

Thus, so far as the company is concerned, it is neither bound by, nor can have the benefit of, a pre-incorporation contract. But this is subject to the provisions of the Specific Relief Act, 1963 of India. Section 15 of the Act provides that where the promoters of a company have made a contract before its incorporation for the purposes of the company, and if the contract is warranted by the terms of incorporation, the company may adopt and enforce it.

"Warranted by the terms of incorporation" means within the scope of the company's objects as stated in the memorandum. The contract should be for the purposes of the company. A person, who intended to promote a company, acquired a leasehold interest for it. He held it for sometime for a partnership firm, converted the firm into a company which adopted the lease. The lessor was held bound to the company under the lease [*Vallie Pattabhirama Rao v Ramanuja Ginnign*

& Rice Factory (P) Ltd, (1986) 60 Comp Cas 568 AP.] A new contract can also be made by the company after incorporation in terms of the earlier contract, *Howard v Patent Ivory Mfg Co*, (1988) 38 Ch D 156. An implied contract may arise if the company after incorporation acts on the contract but not when it is under mistaken belief of being bound by the earlier contract, *Northumberland Aveneu Hotel Co, Re*, (1986) 33 Ch D 16CA].

According to a decision of the Supreme Court of India, the company has to accept the transaction but it is not necessary that the transaction should be mentioned in the company's articles. The very fact that the company was seeking a declaration of its ownership of the property which the directors had purchased for it before incorporation was sufficient to signify acceptance of the transaction [*Jai Narain Parasrampuria v Pushpa Devi Saraf*, (2006) 133 Comp Cas 794 SC]. A contract to allot shares after the company is incorporated entered into before the incorporation of the company is not for the purposes of the company so that the company cannot enforce it against the other party [*ImperialTea Mfg Co v Munchershaw*, (1889) 13 Bom 415].

Commencement of Business [SEC. 63]

A Private company may commence its business right from the date of its incorporation. However, where an approval/license is to be obtained from the concerned body pursuant to the prevailing law to carry on any specific transactions, the company shall commence its transactions only after obtaining such approval/license. The business commencement certificate (Sec. 63) would not apply to a private company converting itself into a public company. But, in the case of a new public company, a further certificate for the commencement of business has to be obtained.

This becomes necessary where a company has issued a prospectus inviting the public to subscribe for its shares. It will be entitled to the certificate subject to the following conditions under Sec. 149(1) of the Indian Companies Act:

(a) Shares payable in cash must have been allotted up to the amount of the minimum subscription;
(b) Directors must have paid in cash the application and allotment money in respect of the shares contracted to be taken by them for cash;
(c) No money is liable to become refundable to the applicants by reason of failure to apply for or to obtain permission for share or debentures to be dealt in on any recognized stock exchange.

A declaration signed by any director of the company or its secretary that the above requirements have been complied with should be filed with the Registrar. When this is done, the Registrar certifies that the company is entitled to commence business. The certificate is conclusive evidence that the company is so entitled to commence business [S. 149(3). A writ cannot be issued to cancel the certificate of commencement, *Muluk Mohamed v Capital Stock Exchange Kerala Ltd*, (1991) 72 Comp Cas 333 Ker].

No public company may commence any business or exercise any borrowing power unless this certificate is obtained [S. 149(4). Kodak Ltd v Srinivasan, (1936) 6 Comp Cas 440 Mad. The

company becomes entitled to all kinds of business operations necessary for the attainment of its objects. *Kishangarh Electric Supply Co Ltd v State of Rajasthan*, AIR 1960 Raj 149. Research, explorations, search for markets, mobilization of resources and other preliminary things can be undertaken even without the certificate]. Any contract made before the date at which the company is entitled to commence business shall be provisional only and shall not be binding on the company until the certificate is obtained [S. 149(6) imposes a penalty for any contravention of these provisions].

Sec. 63(3) puts the condition that the amount called up to be paid against the shares agreed to be taken up by its promoters have been paid up fully.

Certain internal formalities which would be needed are appointing a chairman, adopting a common seal, opening a bank account, and allotting shares either to raise capital or otherwise to the subscribers. These formalities would require a meeting of directors and are permitted before obtaining the certificate of commencement of business under this section. [Sec. 63(4)].

But Nepal Companies Act 2021, had the provision for a preliminary report and preliminary meeting. Only after submitting the preliminary (Statutory) report and the preliminary meeting minutes, the certificate to commence business was given. This was insisted for private companies also. But the companies Act 2053 made it clear that only in case of public companies the preliminary report and preliminary meeting was required to obtain certificate to commence business. But the present Act makes a provision for submission of information usually contained in the preliminary (Statutory) report to be submitted by public company every year to OCR under sec.78 and no preliminary or statutory meeting is required.

Further, if any other authorities have imposed any other condition while granting license, then proof that such conditions have been complied with also should be submitted. Until such certificate to commence business is obtained except matters like holding extra ordinary general meeting, board meeting, administration of the Company, no any action that will create financial liability shall be undertaken.[Sec.63(4)]

For example, the paid up capital of a public company should be minimum Rs. 1 Crore. Then proof that Rs. 1 crore has been paid up should be proved. If it is less than Rs.1 crore, then OCR can refuse to give the certificate to commence business [Sec 63(3) proviso] But if the company is required to take permission/ license to carry on the business from other regulators, like specified industries, insurance, banking, financial companies, then they can be issued certificate to commence business only after submitting such license. [Sec.63 (5)]

This applies to private companies also who are not authorized to commence business without obtaining the license, even though they are not required to obtain certificate to commence business under the Act, eg. a private company incorporated to act as insurance agent shall obtain license from the Insurance Board. [Sec.63 (6)]

Sources of Company Law

As far as domestic companies are concerned, the immediate sources of the rules applicable to them, and the hierarchy of those sources, are the ones familiar to students of other bodies of law. They are Primary Legislation, Secondary Legislation, rule -making by legislatively recognized bodies, the common law of companies, and the company's own constitution (its memorandum and article of association). Of these, the last may perhaps appear unfamiliar, but students of contract law are used to the idea that the rules applicable in any particular situation are as likely to be found in the terms of the parties' agreement as in legislative or common law rules, and students of trade union law or of the law of other types of association know that the particular association's rule book is an important source of law, at least for its shareholders. As to the third category, legislation may delegate to bodies outside the legislature recognized for the purposes of rule making just as Office of Company Registrar is authorized to issue notifications under companies Act.

Finally, and standing outside the above hierarchy but with links to it, there may be examples of self-regulation where the relevant rules have no legislative or common law foundation, but are nevertheless observed in practice, as a result of non-legal pressures, including the threat that government might intervene with legislation if the self-regulatory rules were not obeyed. The leading example of this phenomenon in England is the City Panel on Take-Over and Mergers and the Code it administers. Self-regulatory rules necessarily exist outside (or, better, alongside) the sources of formal law.

In Europe, the European Economic council issues directives to its member states to bring uniformity in company legislation intended to protect the cross border investors and the member states are bound to give effect to such directives by suitable amendment of legislation or issue of executive orders.

Whatever the source of the rule, one should also note that its content may be located on a spectrum running from "hard" to soft. At the hard end, the obligation may be imposed by the rule without giving those to whom it applies any choice whether they comply with it a "mandatory" rule. Moving along the spectrum, the rule may permit those towhom its prima facie applies to modify or remove the obligation. Such rules, conventionally called" default rules" are in fact quite common in company law. Only if the particular parties want something different from that normally adopted will they have to go through the process of altering the rule. Thus, section 67(11) of the Companies Act makes some provisions about the conduct of meetings of shareholders, which rules apply, however, "in so far as the articles of the company do not make other provision in that behalf". Since it is relatively easy for companies to make different provisions in their articles, section 67(11) may be regarded as a pure type of default rule.

Legislation

One major factor attending legislation as long as the Companies Act is that a major commitment of Parliamentary time by the government is required to get such legislation onto the statute book. This can be a distinct disadvantage to those parts of the Act which relate to matters where the technical

or economic context is changing rapidly and fairly frequent up-dating of the legislation would be desirable. One solution of this problem is greater use of subordinate legislation, for which the process of Parliamentary Scrutiny is much reduced and which therefore much less time-consuming. There are already examples of such provisions in the Act. One is Section 84(2) giving the Office of the Registrar of the Companies power to notify the format of financial statements (Accounting Requirements) by statutory instrument, in some cases subject to affirmative resolutions of Parliament, in less important cases subject to negative resolution. Greater use is being made of secondary legislation and the Government has provided for it in the present Companies Act.

Delegated Rule Making

Although quicker than primary legislation, secondary legislation suffers from two defects. The first is that rules are subject to less democratic scrutiny than an Act of Parliament. The second is that secondary legislation may not be as expert as rules produced by rule-makers closer to the regulated, despite the conscientious consultation process in which the Office of the Company Registrar engages before making secondary rules.

(a) Financial Services Authority

The Stock Exchange and Securities Board of Nepal (SEBON) have exercised their powers to issue an elaborate set of Rules for listing, prospectus, and issue of right shares, without the need for formal approval by either Parliament or a governmental department. The public interest is protected, however, by the specification in the legislation of a set of general objectives by which the Authority is bound and which could be used as a basis for judicial review of the rules.

(b) Accounting Standards Board

The second area where delegated rule-making is to be found on a substantial scale in the present law is in relation to company accounts, though here the legal status of the rules made by the body in question is less robust than that of the SEBON rules. In general, companies are required to produce on an annual basis a balance sheet and profit-and-loss account, a major technical task for those involved in this process is working out how the very many different types of transactions businesses undertake should be presented in the accounting terms. Characterizations of transactions for the purposes of drawing up the accounts is not a clear-cut-task., and sometimes very considerable variations in a company‘s reported profits or other financial data can depend on which choice is made. To address this problem is the role of accounting standards. To some extent, the legislation controls this process of standard setting, by specifying itself the appropriate standard.

4 MEMORANDUM OF ASSOCIATION

An important step in the formation of a company is to prepare a document called the memorandum of association. As observed by Palmer ‘It is a document of great importance in relation to the proposed company’. Its importance lies in the fact that it contains the following fundamentals clauses which have often been described as the condition of the company‘s incorporation:

1. Name Clause;
2. Registered Office Clause;
3. Objects Clause;
4. Liability Clause;
5. Share Capital Clause;

But Companies Act (section 18) has made provision for mentioning the following also in the Memorandum of Association:

(a) Types of shares of the Company, rights and privileges vested in such shares, value of each share, and the number of each category of shares.
(b) Restrictions, if any, on the purchase or transfer of shares.
(c) The number of shares which the promoters have agreed to take for the time being.
(d) Terms of payment of the share amount.
(e) The maximum number of shareholders, in the case of a private Company.
(f) Other necessary matters

Name

The first clause of the memorandum is required to state the name of the proposed company. A company, being a legal person, must have a name to establish its identity. 'The name of a corporation is the symbol of its personal existence'. Any suitable name may be selected subject, however, to the following restrictions.

Legal requirements as toName

(a) Resembling or identical names not allowed [Sec. 6]

In the first place, no company can be registered with a name which is undesirable. As per sec. 6 of the Companies Act, a name is undesirable if:

(i) There is a previously registered company bearing that name,
(ii) A name is undesirable if it is identical with or too nearly resembles a registered trade mark which is the subject of an application for registration of another person.
(iii) If the name of the proposed company is contrary to the prevailing law or appears to be improper or undesirable in view of public interest, morality, decency, etiquette etc. or reflects criminal motive ; or
(iv) If the name of the proposed company is identical with the name of a company of which registration has been cancelled pursuant to this Act or that of a company which has been insolvent under the prevailing law or so resembles such name as it might cause misleading and a period of five years shall not expired after such cancellation of registration or insolvency,

The name of the company should not be identical with or should not too nearly resemble, the name of another registered company, for such a name may be declared undesirable by the Office of Company Registrar.

The promoters have to seek an advance approval of the name and once an advance approval is granted to a particular applicant, the Office of Company Registrar shall not make that name

available to any other applicant for 35 days. The Office of Company Registrar may, as per existing procedure, allow the same name to any other applicant, if otherwise available, after 35 days from the date when the name was allowed to the original promoters.

Moreover, an existing company may also apply for an injunction to restrain the newcomer from having an identical name.

The reason for the rule was explained by LAWRENCE J in Society of Motor Manufacturers and Traders Ltd v Motor Manufacturers and Traders Mutual Insurance Co. Ltd. Hesaid "Under the Companies Act, a company by registering its name gains a monopoly of the use of that name since no other company can be registered under a name identical with it or so nearly resembling it as to be calculated to deceive" [(1925) 1 Ch 675, at 686-7]. The name of a company is a part of its business reputation and that would definitely be injured if a new company could adopt an allied name.

The resemblance between the two names must be such as to be "calculated to deceive". A name is said to be "calculated to deceive" when it suggests that the corporation adopting it is in some way connected or associated with the existing corporation. In the case referred to above: The plaintiff society was incorporated in 1902 under the name: The Society of Motor Manufacturers and Traders Ltd. In 1924 the defendant society was incorporated under the name: Motor Manufacturers and Traders Mutual Insurance Ltd. The plaintiff company brought an action to restrain the use of this name.

It was held that the defendant company's name could not be regarded as one "calculated to deceive". "Anyone who took the trouble to think about the matter would see that the defendant company was an insurance company and that the plaintiff society was a trade protection society and I (LAWRENCE J) do not think that the defendant company is liable to have its business stopped unless it changes its name simply because a thoughtless person might unwarrantedly jump to the conclusion that it is connected with the plaintiff society".

According to a practice direction issued by the Companies Registrar in England, a name is misleading when the company is with small resources, but the name suggests that it is trading on a great scale or over a wide field. The name must not suggest connection with an unlawful activity or be offensive in form. Two women forming a company for their personalized services were not allowed the name "Prostitutes Ltd". The name 'Air Equipment' was held to be not available name because a comparison of the names 'Air Equipment' and 'Air Component' in the context of all the circumstances in which they were actually used or likely to be used, namely the types of products the companies dealt in, the location of the business, the types of costumers and the persons involved in the operation of the two companies, suggested an association between the two companies or what they were a part of the same group. The name 'MRJ Contractors Ltd.'s held to be as nearly similar to 'MPJ' Construction Ltd' as it was possible to be misleading. This effect could not be avoided simply by adopting a stationery of a different style. The get up adopted by a company could be an important element in public awareness or perception of a company but it could not have the effect of allowing a company to rely on its get up to avoid the thrust of the prohibition on similar names.

When a company is directed to change its name, the court cannot directly tell the Registrar to effect the change in the name of the company. It can only direct the company to do so. The company would have to follow the prescribed statutory procedure of special resolution and approval and then filing the documents with the Registrar. The company cannot simply file the court order regarding the change.

(b) Use the word "Limited" and Publication of Name

Secondly, whatever be the name of the company, if the liability of the shareholders is limited, the last word of the name be "Limited", and in the case of a private company "Private Limited".This is to ensure that all persons dealing with the company shall have clear notice that the liability of the members is limited. And for the same reason, it is further required that such name of the company must be painted on the outside of every place where the business of the company is carried on [S. 184.] Sec 147(2) of Indian Companies Act imposes penalty for default upon "the company and every officer of the company who is in default"]. Such name, including the address of the registered office, must also be mentioned on all business letters and other official publications, on all negotiable instruments issued or endorsed by the company and on all other orders, receipts, etc. This was provided in section 62(2) of the Companies Act of 2021. But this is omitted in the present act as well as the 2053 Act. Any default in this respect might involve the officers of the company in most serious consequences. For example, if a bill of exchange is issued by a company on which its name is not properly mentioned or if the word 'limited' has been omitted, and if the company fails to pay the bill, the officer who issued or authorized the issue of such a bill would be personally liable under it and will also be punishable with a fine [S. 147(4)of Ind. Com. Act) S. 148 of Indian Companies Act requires that documents issued by the company mentioning its authorized capital must similarly mention the amount actually subscribed and paid-up].but still to know the location of the company and its character these will have to be observed. It is also necessary for a person to serve notice on the company But the omission must be deliberate or of negligent origin and not merely accidental. Thus in *Dermatine Co. Ltd. v Ashworth* [(1905) 21 TLR 510]: A bill of exchange was drawn upon a limited company in its proper name and it was accepted by two directors of the company, the word "limited", however, did not appear in acceptance. The reason was that the rubber stamp by which the words of acceptance were impressed on the bill was longer than the paper of the bill, and therefore, the word "limited" overlapped the paper.

On the company's failure to pay the bill, it was held that the directors would not be personally liable there on. "It was an obviouserror of most trifling kind and them is chief aimed at by the Act did not here exist".

But in *Nassau Steam Press v Tyler:* [(1894) 70 LT 376.] The registered name of a company was Bastille Syndicate Ltd. The defendants who were the directors and the secretary of the company accepted a bill of exchange on its behalf giving the name of the company as The Old Paris and Bastille Ltd. No action will be possible where the omission is due to the holder's own conduct; *Durham Fancy Goods* v *Michael Jackson (Fancy Goods) Ltd.,* [(1968) 2 QB 839: (1968) 2 All ER 987: (1968) 2 Lloyd's Re98.]

It was held that the name of the company was not mentioned in accordance with the requirements of the Act and that the company not having paid the bill, the defendants were personally liable thereon. The correct name of the company should be inserted. Any omission or addition amounting to misdescription would make the person purporting to sign the bill personally liable.

On the same principle, the directors were held personally liable on a cheque signed by them on the company‘s behalf stating the name as “L R Agencies Ltd”, the real name being “L & R Agencies Ltd” [Hendon v Adelman, The Times, June 16, 1973: Noted 1973 New LJ 637]. The personal liability imposed by the section is not identical with the liability of the company. Thus where the name of the company was not fully stated on a company, the liability of the officer was not thereby discharged. The liability arose when the cheque was dishonored and could not be affected thereafter in the way in which the liability under a contract of guarantee might be affected. Taking note of the modern banking practice to issue to the customers cheque forms showing the name of the customer and his account number, a director who had inserted his bare signature on such cheques was held to be personally not liable when they were dishonored. Commenting on this it has been said: [1986 JBL 9-10, editori all note].

The decision will be welcomed by the business communities. As the cheque contained the printed name and account number of the company, the payee could be under no doubt that the cheque was a company cheque. The Draconian imposition of personal liability on a director, who signed a company cheque without indicating his representative capacity, has thus lost much of its sting.

Acceptance in full form of a bill which was drawn on the company in an abbreviated name was held to be alright, *Stacey &Co Ltd v Wallis*, (1912) 28 TLR 209. An order for supply of goods placed innocently in the old pad of the company carrying its old name did not make the signor personally liable, *John Wiles (Footwear) Ltd v Lee International (Footwear) Ltd*, (1985) BCLC 444] Misdescription of name does not, however, affect the validity of the contract. “A limited company has characteristics other than its name by reference to which it can be identified”.

Change of Name [Sec.21(3)]

A company may change its name by passing a special resolution and with the approval of the Office of Company Registrar signified in writing. But if a company has been registered with a name which subsequently appears to be undesirable or resembling the name of another company, it may change its name.

The British Diabetic Society was compelled to change its corporate name to something that would not impinge upon the goodwill of the British Diabetic Association. There was a sufficient similarity between the two names to necessitate a change, even though there was no intention to mislead the public. [*British Diabetic Assn v Diabetic Society*, (1995) 4 All ER 812, *Kothari Products Ltd v ROC*, (2001) 103 Comp Cas 841 All, company registered under the name of “Parag International (KNP) (P) Ltd”. The owner of the trade mark ‘‘Parag’’ obtained an order

from the court directing the Registrar to cancel the registration and permitting the company to apply for change of name.]

An injunction was not allowed to prevent the use of an ancestral name (Kirloskar). There is a right to use in *bona fide* manner one's own or the name of a place or ancestral name.

When a company changes its name, it becomes the duty of the Office of Company Registrar to check it subject to section 6, approve and enter the new name in the register, if appropriate and then to issue a new certificate of incorporation noting down such alterations. Change of name becomes effective only on the approval of such new name.

Change of name does not affect the rights and obligations of the company. For Section 23(3) of Indian Companies Act provides: The change of name shall not affect any rights or obligations of the company, or render defective any legal proceedings by or against it; and any legal proceedings which might have been continued or commenced by or against the company by its former name may be continued by or against the company by its newname. But Companies Act 2063 has not made any such clear provision but the principle will remain the same.

The degree of protection afforded by this provision was considered by the *Calcutta High Court in Malhati Tea Syndicate Ltd v Revenue Officer.*

A company had changed its name from "Malhati Tea Syndicate Ltd" to "Malhati Tea and Industries Ltd". It filed a writ petition in its former name.

Declaring the petition to be incompetent, the court said: Nothing in this sub-section [S. 23(3)] authorized the company to commence a legal proceeding in its former name at a time when it had acquired its new name which has been put on the register of joint stock companies.

Registered Office

The second clause of the Memorandum of Association shall specify the place at which the registered office of the company is to be situated.

Before registration, there is no existence of the company and it cannot have a present address but only a proposed address. Under the Indian Companies Act, within thirty days of incorporation or commencement of business, whichever is earlier, the exact place where the registered office is to be located must be decided and notice of the situation given to the Registrar who is to record the same. Under section 184(2)] of Companies Act 2063, the company has to intimate the OCR within three months from the incorporation date of the company. All communications to the company shall be addressed to its registered office. The company has to give its telephone number, fax number, e-mail etc.to the OCR and any changes in the same also to be notified immediately.

Change of Registered Office Location

A company may shift the address of its registered office from one place to another. In such case, the company shall amend its location of registered office mentioned in the MoA and AoA by adopting the amendment procedure mentioned under Section 21 of the Act. The Office of Company Registrar is required to maintain a record of the registered offices of the companies registered along with the phone no., fax no. and e-mail and keep the record up to date with any changes intimated. The same shall be kept open for inspection for the public [Sec.184 (5)].

Where some employees objected to the proposed shifting on the ground that they would be prejudiced in respect of their cases pending before labor courts, the CLB of India permitted the shifting but ordered that the workers interest should be safeguarded, and that none of them should be prejudiced either by way of transfer or retrenchment or otherwise and that pending cases before local courts should not be prejudiced. A person who has no stake in the company either as a shareholder or as a creditor was not allowed to raise any objections. He was personal creditor of the managing director. He had no *locus standi,* his criminal proceedings against the managing director not with standing.

Where a company had all its manufacturing units in Uttar Pradesh and none in West Bengal, the CLB confirmed its special resolution to shift its registered office from West Bengal to Uttar Pradesh. Where a company had one manufacturing unit in Bihar and the other in Maharashtra and because it had undertaken massive expansion program in Maharashtra, its desire to carry the registered office to Pune was allowed. Its Bihar unit was to continue as it was. A company was allowed to take away its registered office from Bihar to West Bengal in spite of the fact that the Bihar Government had granted land on lease for the company‘s factory on the condition that the registered office would not be shifted. The CLB said that the fact of interest-free loans, sales-tax, holidays, concessional electricity and other subsidies had no bearing on the company‘s right to shift.

If the registered office mentioned in the Memorandum is to be changed, then a change of the same will require special resolution to be passed by general meeting of the company and getting approval of the same pursuant to section 21 of the Act.

OBJECTS AND POWERS

The Companies Act, 2063 requires that in the case of companies, the objects clause must be divided into two sub-clauses, namely:

(a) Main Objects: This sub-clause has to state the main objects to be pursued by the company on its incorporation and objects incidental or ancillary to the attainment of the main objects.
(b) Other Objects: This sub-clause must state other objects which are not included in the above clause [Sec.18 (1) (d)].

Objects, Powers and Charitable Contributions

The India Supreme Court decision is an authority for two propositions. Firstly, that a company's funds cannot be diverted to every kind of charity even if there is an unrestricted power to that effect in the company's memorandum, Secondly, that objects must be distinguished from powers. The power, for example, to borrow or to make a charity, is not an object. Objects have to be stated in the memorandum, but not powers. But according to the report of the Jenkins Committee the power to make donations of any kind should not be allowed to be challenged, though the directors might be liable to account if the amount of such donations is unreasonable. [(Comnd 1947), para 52]. Even if powers are stated, they can be used only to effectuate the objects of the company. They do not become independent objects by themselves.

A company had an independent clause in its memorandum empowering it to borrow money on debentures. Yet its act of loan for a purpose known to the lender to be outside the scope of its objects was held to be *ultra vires.*

The power to borrow is not an object. It cannot on its own, but must be exercised in order to promote the company's objects. But it is for the directors to decide in good faith what is necessary to promote the objects of the company. Thus where under an express power to that effect the directors of a company charged its assets to secure a benefit to another company in the same group, the charge was held to be valid. The contention that it was not made in the interest of the company was not accepted. While the separate interest of a company cannot be sacrificed or ignored, yet the directors are not required to consider the interest of an entity in a group in isolation.

Similarly, a power to make charitable contribution cannot be acted upon to make grants of every kind. The validity of such grants must be tested by the answer to three pertinent questions. [Lee Behrens & Co. Ltd. Re. (1932)2: Ch: 46]

1. Is the transaction reasonably incidental to the carrying on of the company's business?
2. Is it *bona fide* transaction?
3. Is it done for the benefit and to promote the prosperity of the company?

Applying these tests to the facts the learned judge held that the grant of an annual pension of £500 to the widow of a managing director five years after his death was *ultra vires.* "The predominant consideration operating in the minds of the directors was a desire to provide for the applicant (widow), and the question what, if any, benefit would accrue to the company never presented itself to their minds".

Similarly, where the directors of a company proposed to distribute the money received on the sale of its assets as compensation to the employees who had lost their jobs, the court restrained the scheme. Their motives may be laudable from the point of view of industrial relations, but the law does not recognize them as a sufficient justification to enable the majority to spend the money of the company. In *Hutton v West Cork Rly Co,* BOWMEN LJ explained the judicial attitude: Charity has no business to sit at board of directors qua charity. There is, however, a kind

of charitable dealing which is for the interest of those who practice it, and to that extent and in that garb, charity may sit at the board, but for no other purpose.

Thus, the interests of the company cannot be elbowed out. Charity is allowed only to the extent to which it is necessary in the reasonable management of the affairs of the company. There must be proximate connection between the gift and the company's business interest. But the question whether the limit has been exceeded has to be considered by keeping in mind the fact that "the image of the business corporation is evolving from the nineteenth century one of a heartless exploiter of a wage slave labor, single mindedly bent upon the maximization of profits to that of the corporate good citizenship of today. Corporations are coming to focus their attention upon their duty to serve mankind. The goal of the enlightened corporation is to provide full employment and high wages for labor, to lower its prices to consumers, to help the needy, to contribute to education and to secure the needs of society generally".

Change of Memorandum Object Clause

Under the Indian Companies Act, Sec. 17 prescribes certain condition for amendment of object clause with a view to enable it,

(a) to carry on its business more economically or more efficiently;
(b) to attain its main purpose by new or imposed means;
(c) to enlarge or change the local area of operation;
(d) to carry on some business which may be conveniently or advantageously combined with the business of the company;
(e) to restrict or abandon any of the objects mentioned in the Memorandum;
(f) to sell or dispose of the whole or any part of undertaking of the company;
(g) to amalgamate with any other company or body corporate.

Similar provision was in the English Act also but in 1989 conditions for changing the object clause was removed but provision was made that shareholders holding not less than 15% of issued capital objecting to the change can apply to the Court to prevent the change taking place within 21 days of the passing of resolution. The same has been adopted in the Company Act of 2063.

In any case, since the change has to be approved by a special resolution requiring three fourth majority, the Court is unlikely to refuse confirmation except in very special circumstances.

Further, the Companies Act 2063 provides that if there are any type mistakes or small errors, the same may be corrected by filing application to OCRwith decision of the board of directors of the company and 2 corrected copies (i.e. *Tin Mahale*with Amended section of MoA or rule of AoA) within one year of incorporation. However, such corrections shall not alter in any way the main objects of the company, by submitting an application for such correction with a corrected copy to the OCR under sec. 19(4). Then, the OCR will examine the corrections and approve it, if appropriate

Amendment of Objects

Section 21 of the Act allows amendment of objects within certain defined limits. "The intention of the Legislature is to prevent too easy an alteration of the conditions contained in the memorandum". The exercise of the power is, therefore, fenced by safeguards which are calculated to protect the interests of creditors and of shareholders. The limits imposed upon the power of alteration are of two kinds, namely, substantive and procedural. The former defines the physical limits of alteration and the later the procedure by which it can be effected.

(a) Substantive Limits

Section 17 of Indian Companies Act provides that a company change its objects only in so far as the alteration is necessary for any of the following purposes:

(a) *To enable the company to carry on its business more economically or more efficiently: -* The alteration which is contemplated in this clause seems to be an alteration which will leave the business of the company substantively what it was before, with only such changes in the mode of conducting it was will enable it to be carried on more economically or more efficiently. In *Scientific Poultry Breeders 'Assn,* a company was allowed amendment to enable it to pay remuneration to its managers, which was formerly forbidden, being necessary for efficient management. The words of this clause have been liberally interpreted. For example, amendments were allowed under this clause to enable companies to make contributions to political parties as this would enable them to go better with the Government and a healthy relationship lead to business efficiency.

(b) *To enable the company to attain its main purpose by new or improvedmeans:* This clause is intended to enable companies to take advantage of new scientific discoveries. With the objects remaining the same, only the means of carrying them out are permitted to be changed under this clause.

(c) *To enlarge or change the local area of the company'soperation:-* This is to enable companies to carry their trades to new quarters of the globe. For example, *Indian Mechanical Gold Extracting Co.,* a company was allowed to drop the words from its memorandum which required it to confine business tothe"empire of India", subject, of course, to the condition that the word "Indian" was dropped from its name.

(d) *To carry on some business which under existing circumstances may conveniently or advantageously be combined with the business of the company:-* This is the only clause which allows a company to undertake any business having no relation to its existing business except that it must be such as can conveniently or advantageously be combined with the company's existing business. What new business can be so combined must be determined by the persons engaged in the business. Thus a tyre company was allowed to undertake the general business of bankers and financiers. The new business must not, of course, be inconsistent with the existing business. Thus, in *Cyclists 'Touring Club,* a club incorporated to protect cyclists on public roads was not allowed to undertake protection of motorists also, as cyclists had to be protected against motorists.

These principles have been largely followed in India also. The choice of new objects must rest with the shareholders of the company and their directors and an alteration will ordinarily be confirmed except when "it is detrimental to, or inconsistent with, the existing business". Thus a company formed originally for "business in jute" has been allowed to include "business in rubber" and a "spinning and weaving company", to manufacture "industrial and power alcohol", a spinning and weaving company, having sold its undertaking, to purchase a running cinema, and a colliery company whose business was nationalized, to adopt new objects. It should not, however, be supposed that the Board's confirmation is a bare formality. The Board has a real discretion, "a discretion to be exercised judicially, in the interest of the members of the company and its creditors, not to confirm the alteration or to confirm the same in whole or in part, or subject to such terms and conditions as it deems fit. Thus the Punjab High Court refused to confirm an alteration as the proposed "new business had nothing to do even remotely with the existing business. Similarly, in a case before the Calcutta High Court, "an alteration to carry on a new business was not confirmed on the ground that it could not by any stretch of language, imagination or business principles or commercial possibilities, be regarded as a business which could conveniently or advantageously be combined with the business of the company in the existing circumstances. But where the company is in sound financial position and the alteration is not objected to by its shareholders and creditors, the Company Court may take a lenient view and allow any kind of alteration resolved upon by the company. Accordingly, when the business of an insurance company was taken over by the Central Government, the Punjab High Court allowed the company to alter its object so as "to include business in engineering works, cotton and importing and exporting". And the same court allowed a cable manufacturing company to undertake hoteling services. Similarly the Madras High Court has held that where a company's assets greatly exceed its liabilities, an expansion of business activities in the light of the company's special resolution should be allowed.

The Company Law Board of India permitted a new object (trading at stock exchange) which was sought by the company some eight years after its incorporation, but insisted that it should not be listed among "main objects" because the new business was not being commenced on incorporation. The CLB also observed that a company could not have a negative objects clauses. If the stock exchange rules were not permitting certain things they could be dropped from the memorandum:

(a) To restrict or abandon any of the object specified in the memorandum.
(b) To sell or dispose of the whole, or any part of the undertaking, of the company.
(c) To amalgamate with any other company or body of persons.

(b) Procedure of Alteration of Objects

The prescribed procedure for altering objects under section 21 of Companies Act 2063 is only the requirement of a special resolution and its filing with the Office of Company Registrar for getting its approval.

Here, the company shall give information of such object amendment prescribed at its MoA to the Office within thirty days of special resolution passed about the same; and the Office shall record the same and give information thereof to the concerned company, within seven days after the receipt of such information.

The special resolution of the company should be within the scope of the permissible range of alteration as outlined in section 6(1)(b). The matter of amending object being wholly internal, only its shareholders can object to any change which is extraneous to the substantive limits stated in Section 6(1)(b). The memorandum of association is a contract between the company and its shareholders. This contract operates within the framework of the Companies Act, 2063. Shareholdersmay prevent through a court action violation of the Companies Act by their company. Lending institutions and creditors would not be able to object. It would, however, be better to inform them and to take their approval because they can think in terms of withdrawing loan facilities where such facilities were extended on the basis of objects as they then stood. They may not like to risk their financial resources in new and adventurous objects.

The Company Law Board in India was also required to have regard to the rights and interests of the members of the company. If there are any dissentient members the Board may order that an arrangement be made for the purchase of the interest of such members. [In *Sipani AutomobilesLtd, Re,* (1993) 78 Comp Cas 557, the CLB refused its confirmation because there was the probability that new business would be financed out of the depositors' money and not by raising new capital, thereby exposing it to new risks.]

Under the English Act confirmation of the Court was not necessary except when an application had been lodged against the alteration within 21 days of the passing of the special resolution. The application had to be filed by the holders of not less than 15 per cent in nominal value of the company's issued share capital or any class thereof. If the company was limited by shares the application had to be filed by at least fifteen per cent of the company's members. Fifteen per cent of the company's debenture holders could also proceed under the section. The English procedure saved a good deal of time and expense. The sanction had already become a needless ritual. Alterations were seldom opposed.

Under Section 21 of the Companies Act 2063, an application may be lodged to the Court against the alteration within 21 days from the date of passing of special resolution under the Companies Act by shareholders of a public company holding at least 5% of the paid-up share capital and who have not given assent for the alteration at the meeting. Such petition right is not available to shareholders of private company or members of company not distributing profit. If one shareholder files the application on behalf others, then the power of attorney in his favor should also be filed.

Along with filing to the Court, the Court should be satisfied that sufficient notice of the matter, date, time & place of the application is also given to the Company. If it is proved that the Company refused to receive the notice, then the Court is not prevented from taking up the application for consideration. The company should be in a position to defend its resolution at the hearing before the court.

Until the final decision or order is made by the Court, the amendment to the objects will not take any effect. The Court may consider and make order with the following terms and conditions:

(a) To accept or reject the amendment of the object clause fully or partly;
(b) To order the Company to purchase the share of the objecting shareholder;

(c) For the above purpose, to order that the purchase of shares to be done out of funds permitted under Sec. 61 or that if no such fund is available, then the Company shall reduce the share capital to the extent of such repayment by passing a special resolution as in the case of reduction of capital and in case such order is passed the company should make suitable amendments in its Memorandum of Association & Articles of Association in accordance with the procedure prescribed in the Act.

Where the Court has passed an order, confirming or rejecting in full or in part the amendment passed by the Company, the Company cannot amend its objects in the Memorandum & Articles of Association without the permission of the Court or in violation of the order of the Court.

The Company has to give notice of special resolution altering the clause of Memorandum & Articles of Association within 30 days of passing such special resolution to the office of company registrarwho should record the same and give approvalof the same within 7 days of application received.

Registration of Amendment [Section 21(2)]

Within 7 days of filing the application regarding the amendment of MoA and AoA, the Office of Company Registrar shall record the same and give information thereof to the concerned company. Such amendment takes effect when it is so registered.

Liability Clause

The fourth clause has to state the nature of liability that the shareholders incur. If the company is to be incorporated with limited liability, the clause must state that liability of the shareholders shall be limited up to the par value of shares prevailed at the time of its subscription. This means that no shareholdersmay be called upon to pay anything more than the nominal value of the shares held by him, or so much thereof as remains unpaid; and if his shares be fully paid up, his liability is nil.

Capital Clause

This clause states the amount of the authorized, issued and paid up capital of the company and the number and value of the shares into which it is divided. The Companies Amendment Act, 2000 of India has, by amending section 3, prescribed the requirement that a public company must have a minimum paid up capital of one crore rupees or such higher amount as may be prescribed. Similarly, section 11 of the Companies Act, 2063 also prescribes that a public company shall have Rs. one crore minimum paid up capital. The capital should be paid up soon after the incorporation of the company. Therefore, promoters themselves shall have to subscribe, at minimum, to a paid up capital of Rs. One crore at the time of incorporation. Until Rs. One crore is paid into the company‘s bank account, the certificate to commence business Sec. 63 of the Act shall not be issued.

Subscription Clause

The memorandum of association concludes with the promoters’declaration and commitment. The promoters declare: “We, the several persons whose names and addresses are mentioned, are

desirous of being formed into a company, in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set opposite our respective names. The particulars given regarding out name, address, signature, shares that we have undertaken to subscribe and the particulars regarding the witness are true and correct. If for any reason, they turn out to be false, we shall be responsible for all liabilities created after the incorporation of the company. The matters mentioned in the Memorandum are true and correct, if found false, we agree to bear the legal consequence of the same".

The memorandum has to be subscribed by at least seven persons in the case of a public company and by at least one in the case of a private company. Each promoter shall sign the document and must write opposite his name the number of shares he commits to subscribe. But, no promoters shall subscribe less than the number of shares provided in the AoA to be a promoter. If the AoA has not provided, each promoter shall subscribe minimum 100 share units as per Sec. 20 of the Act. In the case of single shareholder private company, the single promoter signs them memorandum.

After incorporation, no promoter can withdraw his name on any ground whatsoever. Instead, he may transfer his shares to other person. The promoter to the memorandum cannot have rescission on the ground that he was induced to become a subscriber by the misrepresentation of an agent of the company. But, he may withdraw his name before the memorandum is actually registered as up to that time "there is no contract at all".

5 ARTICLES OF ASSOCIATION

What Constitutes the Constitution ?

Despite the increasingly common usages of the phrase "the company's constitution, it is not a term which is used generally in the Act and so is not defined generally by the Act. What is clear is that the terms of company's constitution are to be found at present in more than one document. At the formation stage, the Act concerns itself with two documents: the "memorandum of association" and the "article of association". It is those two documents which are normally referred to under the heading of "the company's constitution". They are, however, very different types of instrument. The memorandum of associationcontains a specified minimum content regarding substantive law provision and normally contains little more than the required subject matter. However, the article of association contains a content regarding procedural law provision very much under the control of those who establish the company (the incorporators) and subsequently of the shareholders of the company. It tends therefore to be quite an elaborate document and the point that the internal affairs of the company being regulated by the company's constitution applies especially to the article of association.

The Legal Status of the Article of Association

The English law tends to classify the rule-books of associations, whether they are clubs, trade unions, friendly societies or others, as contractual in nature. The articles of association are no exception to this principle. It has been provided that the memorandum and the article, shall, when registered, bind the company and its shareholders to the same extent as if they are respectively had been signed and sealed by each shareholder, contained covenants on the part of

each shareholder to observe all their provisions, and that money payable by a shareholder to the company under the memorandum or article shall be in the nature of a specialty debt.

What is clear, is that the article constitute a rather peculiar form of contract, and the peculiarities of that contract need to be noted here as follows:

(a) The parties to thecontract

The article of association constitute a contract between the company and each shareholder. Further, the contract is enforceable among the shareholders inter se. The principal occasions on which this question is likely to be important arise when articles confer on shareholders a right of pre-emption on first refusal when another shareholder wants to sell his shares. Or, more rarely, impose a duty on the remaining shareholders or the directors to buy the shares of a retiring shareholder. A direct action between the shareholders concerned is here possible; and for the law to insist on action through the company would merely be to promote multiplicity of actions and involve the company in unnecessary litigation. Thus, the contract created by the company law is a multi-party contract, not that this feature in itself distinguishes it from many other types of contract found in the commercial world.

(b) The contract as a public document

Although the article of association may have a contractual status, they are clearly more than a private bargain among the company and its shareholders. As we have seen above, the company‘s article become a public document at the moment of formation, will apply or because the company registers its own article which amend or even fully replace the statutory model. Those who deal with the company have a legitimate expectation that the registered article represent an accurate statement of the company‘s internal regulations. From this situation, the courts have concluded that standard contract law should be applied to the article with the certain restrictions. The courts are reluctant to apply to the statutory contract those doctrines of contract law which might result in the articles subsequently being held to have a content substantially different from that which someone reading the registered documents would have concluded.

(c) Altering the contract

The function of the article of association as a constitution for an ongoing company requires that it is capable of amendment from time to time. Section 21 expressly provides that “*Subject to the Section 6, the general meeting of a Company may amend its Memorandum or Article of Association by adopting a special resolution for the purpose*”.

It further states “Not with standing *anything contained in Sub-Section (2), in case the Company is required to alter its name, it* shall *pass a special resolution at its general meeting and apply to the office along with the prescribed fee for its prior approval. In case the Office grants its approval to alter the name as mentioned in the application so received, the name of the Company may be altered”.*

From these provisions it may be concluded that only “subject to the provision of this Act” the articles of association may be altered. Those provisions include the section which permits of alteration of the articles of association by means of special resolution of the shareholders in

general meetings. Thus, the company cannot contract out of its power to alter the articles. For example, by providing in the articles of association, a particular provision shall not be alterable. A majority of the shareholders shall normally be able to alter the articles by following a prescribed procedure and thus alter for the future the contractual and obligation of the individual shareholder is hardly surprising. It reflects in fact that the company is an association and that some process of collective decision-making is needed, in relation to its constitution, if it is to be able to adapt to changing circumstances in the business environment. The alternative would be constitutional change only with the consent of each individual shareholder, which would be very difficult to obtain in many cases and which would give unscrupulous individuals golden opportunities for disruptive behavior.

On the other hand, the ability of the majority to bind the minority through decisions which alter the articles of the company creates the potential for opportunistic behavior on the part of the majority towards the minority. Here we need note only two particular restrictions on majority power to alter the articles. One is highly precise. The consent of the individual shareholder is required for him or her to be bound by an alteration which requires him to subscribe for further shares in the company or increases his or her liability to contribute to the company‘s share capital or pay money to the company.

The other provision is more general and enables the shareholders to entrenchprovisions of the company‘s constitution, i.e. to make them unalterable or alterable only in a specially demanding way .This can be done by placing the provision, not in the articles but in the memorandum of association, and, in addition by providing in the memorandum that the provision shall not be alterable or alterable only in a particular way.

(d) Who can enforce the contract?

The standard answer to this question at common law is: the parties to the contract. Since it is shareholders who are party to the contract with the company, it would follow that non-shareholders cannot enforce the contract, even if they are intimately involved with the company, for example, as directors. Suppose, however, a person is both a shareholder of the company and one of its directors. Can he or she enforce rights conferred by the articles, even if the right is conferred upon the claimant in his or her capacity as director of the company? The answer appears to be in the negative. The decisions have constantly affirmed that the section confers contractual effect on a provision in the articles only in so far as it affords rights or imposes obligation on a member qua member. As Ashbury J. said in the *Hickman case:* “An outsider to whom rights purport to be given by the articles in his capacity as such outsider, whether he is or subsequently becomes a member, cannot sue on those articles, treating them as contracts between himself and the company, to enforce those rights”.

The same applies to the contract between the shareholders. On the wording of the section, it would be difficult to interpret it as creating a contract with anyone other than the company and the shareholders. Further more, there is obvious sense in restricting the ambit of the section to matters concerning the affairs of the company. The question is whether it is justified to restrict the statutory wording for still further, so that it applies only to matters concerning a member in his capacity of member. As a consequence of this interpretation, a promoter, who becomes a

member, cannot enforce a provision that the company shall reimburse the expenses he incurred nor a solicitor, who becomes a member, a provision that he shall be the company's solicitor. More important, this approach to the section apparently prevents a member who is also a director or other officer of the company from enforcing any rights purporting to be conferred by the articles on directors or officers. Only if he has a separate contract, extraneous to the articles, will he have contractual rights and obligations *vis-a-vis* the company or his fellow members. For this reason, executive directors will be careful to enter into service contracts with their company (into which it is entirely permissible to incorporate provisions from the articles of association) in order to safeguard their remuneration, and non- executive directors would be well advised to do so also.

It is somewhat anomalous to treat director as "outsiders" since for most purposes, the law treats them as the paradigm "insiders" (which members, as such, are not) and they will breach their fiduciary duties and duties of care if they do not act in accordance with the memorandum and articles. It also produces some strange results. *Hickman's* case concerned a provision in the articles stating that any dispute between the company and a member should be referred to arbitration and this was enforced as a contract. But in the later case of *Beattie v Beattie Ltd,* where there was a similar provision, the Court of Appeal, relying on the dictum in *Hickman,* held that a dispute between a company and a director (who was a member) was not subject to the provision because the dispute was admittedly in relation to the director qua director. In the still later case of *Rayfield v Hands,* the articles of a private company provided that a member intending to transfer his shares should give notice to the directors "who will take the said shares equally between them at a fair value". A member gave notice but the directors refused to buy. Vaisey J. felt able to hold that the provision was concerned with the relationship between the member and the directors as members and ordered them to buy.

(e) Which provisions can be enforced by the shareholders?

Even though a shareholder sues as a shareholder and even though he sues to enforce a provision in the articles which appears to confer a right on him, he or she may nevertheless be defeated by the argument that the provision does not confer a personal right on the member but an obligation on the company, breach of which constitutes "a mere internal irregularity" on the company's part. The consequence of the categorization of the breach of the article as an internal irregularity is that the decision whether to sue to enforce the provision is a matter for the shareholders collectively, whereas personal rights, not surprisingly, can be enforced by individual shareholders.

If, for example, the chairperson of the meeting acts in breach of the articles governing meetings, is that an infringement of the shareholders'personal rights or a mere internal irregularity? There are a number of decisions of the courts over the past one hundred and fifty years putting such breaches in one category or the other, but it is difficult to discern the principled basis on which the classification was carried out.

All duties imposed to shareholders under the MoA & AoAshall be enforceable by individual shareholders. In principle, if the company acted in breach of such duties, then the shareholder would be able to bring an action to enforce the company's "rule-book". Or the shareholder

would be able to sue another shareholder, if the obligation was laid by the articles on that shareholder. This would not mean that every breach of the articles by a corporate officer would entitle each shareholder to sue the company for damages. Damages would be an available remedy only if the shareholder personally had suffered loss as a result of the breach. In the case of a breach of procedure in the conduct of a meeting, a remedy other than damages might well be more appropriate, for example, an injunction preventing the company from acting on an improperly passed resolution.

If the breach of procedure had been purely technical and it was clear that the resolution would have been passed even if the correct procedure had been followed, the court may not grant any remedy at all and might even award costs against the complainant shareholder. However, this proposal is subject to one qualification: it would be possible for the shareholder to opt, by an appropriate provision included therein, for some or all of the articles not to be enforceable. In such a case, the relevant articles would not be enforceable as a contract, even if they would be under the current law.

Shareholder Agreements

The freedom of the shareholders to fashion the company‘s constitution facilitates the input of a significant element of “private ordering” into the rules governing the company, but the articles of association are not the only method whereby the shareholders can generate their own rules for the governance of their affairs. An alternative method is an agreement, concluded among all the shareholders, but existing outside and separate from the articles and to which the company itself may or may not be a party. Such an agreement is normally treated as part of the constitution of the company, though it may have an effect which is rather similar to a provision in the articles. The main advantages of the shareholders’agreement over the articles are that the agreement is a private document which does not have to be registered at Companies House and that it derives its contractual force from the normal principles of contract law. But under the Nepal companies Act, [Section 4(1) (d)] such agreement between the shareholders of a private company will have to be filed with OCR and the companylaw does not recognize such agreements between the shareholders as binding on the company, unless they are filed to OCR.Further, under section 187 of the Act, an agreemententered into between the shareholders of a company in respect of the management, operation of the company and the use of voting right conferred to them shall be binding on them.

Provided, however, that if any provision of such agreement is prejudicial to the interest of the company or its minority shareholders, such provision shall *ipso facto* be invalid to the extent.

To make the agreement enforceable by law, the concerned shareholder shall submit two copies of the agreement entered into under Sub-section (1) to the company within fifteen days after the date on which such agreement was entered into. The company shall submit a copy of the agreement so received from the shareholder to the Office within fifteen days after the receipt of the same.

The main disadvantage is that the shareholders’agreement does not automatically bind new shareholders of the company, as the articles do. A new member of the company will not be

bound by the agreement unless that person assents to it and so the shareholder agreement may not continue to bind all the members. Securing the assent of new shareholders may or may not be easy to bring about. Nor does the Act provide an overriding mechanism for majority alternation to the shareholders'agreement. The parties to that agreement may provide such a mechanism, but if they do not do so, then the consent of each party to the agreement would apparently be necessary to effect a change. In short, a shareholders'agreement displays both the advantage and disadvantages of private contracting.

Articles of Association in relation to Memorandum of Association

Articles have always been held to be subordinate to the memorandum. If therefore, the memorandum and articles are inconsistent, the articles becomes void to the extent of such inconsistency [Sec. 20]. In other words, articles must not contain anything the effect of which is to alter a condition contained in the memorandum or which is contrary to its provisions.

In the words of BOWEN LJ: [Guinness v. Land Corporation of Ireland, 1882:22:Ch.D:349]: There is an essential difference between the memorandum and the articles. The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions introduced for the benefit of the creditors, and the outside public, as well as of the shareholders. The articles of association are internal regulations of the company.

But, unless the *ultra vires* rule is abolished, the memorandum will always differ from articles in a principal respect. If a company does something beyond the scope of the objects stated in the memorandum, it is absolutely void and altogether incapable of ratification. Whereas anything done by a company in contravention of the provisions of its articles is only irregular and may be ratified by adopting special resolution atgeneral meeting of shareholders. Now that the objects clause of the memorandum has become alterable by a special resolution only, a company should be in a position to ratify or adopt a transaction by introducing by means of a special resolution suitable or requisite changes in the objects clause

Lastly, it is suggested in Palmer's COMPANY LAW with the authority of a passage in the judgment of JESSEL MR in *Anderson* case, [(1876-77) Ch.D:75] that "though the articles cannot alter or control the memorandum, yet, if there is an ambiguity in the memorandum, the articles registered at the same time may be used to explain it, but not so as to extend the objects". But this rule, as is shown in the above work itself, will not apply to the interpretation "of those portions of the memorandum of association which the Act of Parliament requires to be stated in the memorandum". In any case to quote BOWENL Jagain,"it is certain that for anything which the Act of Parliament says shall be in the memorandum, you must look to the memorandum alone. If the legislature has said one instrument is to be dominant you cannot turn to another instrument and read it in order to modify the provisions of the dominant instrument".

Amendment of Articles of Association [SECTION 21]

Every company has a clear power to alter its articles of association by a special resolution. It is a statutory power given by Section 21 of the Act. Therefore, it cannot be prevented by contract. If,

for example, there is a clause in the articles providing that the company would not introduce any change in its original articles, it will be invalid on the ground that it is contrary to the statute. Similarly, a company cannot deprive itself of the power of alteration by a contract with anyone.

The altered articles will bind the shareholders just in the same way as did the original articles [Section 2 (2) of Indian Companies Act says that articles means the articles of association of a company as originally framed or as altered from time to time. The procedure of special resolution has to be followed for making any change in the articles even if the change is intended only to rectify an error or a mistake, *Scott v Frank F. Scott (London) Ltd*, (1940) 1 All ER 508 CA.]. But the Companies Act Sec. 2(b) defines 'articles' as Article of Association of the company. But that will not give the alteration retrospective effect. A transfer of shares when first presented was permissible within the company's articles, but it was rejected because the stamps were not cancelled. Before it could be presented again, the company changed the articles excluding such transfers. The alteration was held to be effective against the transfer.

Further, the Companies Act 2063 provides that if there are any type mistakes or small errors the same may be corrected within one year of incorporation provided such corrections does not alter in any way the main objects of the company, by submitting an application for such correction with a corrected copy to the OCR under section19(4). Then the OCR will examine the corrections and if it deems proper after examining it, rectify such mistake or errorand keep a record of the same.

The power of alteration of articles as conferred by Section 21 is almost absolute. It is subject only to two restrictions. In the first place, the alteration must not be in contravention of the provisions of the Act. It should not be an attempt to do something which the Act forbids. Secondly, the power of alteration of articles is subject to the conditions contained in the memorandum of association.

(a) Amendment against Memorandum

Sometimes, a change in articles of association seems apparently to influence the memorandum of association. To take, for example, *Hutton v Scarborough Cliff Hotel Co*. [1865:62: ER: 717]. A resolution passed at a general meeting of a company altered the articles of association by inserting the power to issue new shares with preferential dividend. No such power existed in the memorandum. The alteration was held to be in operative.

It must be noted that the memorandum was silent. It neither authorized nor prohibited the issue of preference shares. The court inferred from its silence that it intended equality of status of all the shareholders. But now the courts refuse to draw this inference. The power of alteration of articles is subject only to what is clearly prohibited by the memorandum, expressly or impliedly. This change was brought about by the decision in *Andrews v Gas Meter Co Ltd.* [1897:1Ch.361].

By the 5th clause of a company's memorandum, it was stated that the nominal capital of the company was £60,000 divided into 600 shares of £100 each. Neither in the memorandum nor in the original articles was there any provision as to preference shares. A special resolution was

passed authorizing the directors to issue shares bearing a preferential dividend, which was accordingly done.

It was held that the issue was valid. If this had been forbidden by the memorandum, it could not have been done: but as it was not; it was immaterial that the change quite altered the composition of the company.

(b) Alteration in Breach of Contract

Sometimes an alteration of articles of association may operate as a breach of contract with an outsider. To take for instance, a Madras case. A clause in the articles of a company provided Rs.25000 a month as the remuneration of the company's secretary. The plaintiff accepted the post upon those terms. Subsequently, the company modified the article and reduced the secretary's pay to Rs.20000 a month. Could this be done? The answer depends upon the nature of the contract. If the contract is wholly dependent upon the provisions of the articles, as it was in this case, the alteration would naturally be operative. Articles are subject to the statutory power of alteration. Anyone accepting an appointment purely on the terms of the articles takes the risk of those terms being altered. *[Chidambaram chettiar v. Krishna Iyengar (ILR: 33: Mad: 36)]*

But, where apart from the articles, the company has entered into an independent agreement, the company may repudiate it by changing articles, but it will be answerable in damages for the breach. A company cannot, by altering articles, justify a breach of contract. *Southern Foundries Ltd. v Shirlaw [1940: AC:701*] is the leading authority.

The plaintiff was a director in the defendant company. In 1933, he was appointed as a managing director for a term of ten years. In 1935, the defendant company was amalgamated with another company and new articles were adopted under which powers were taken to dismiss a director. It was further provided that a managing director's appointment would be subject to determination, ipso facto, if he ceased to be director. Under these articles the plaintiff was removed from the office of director. He sued for the wrongful repudiation of the contract. It was held that the agreement was unqualified in regard to the term of ten years. The removal was, therefore, a breach of the agreement for which the employer must answer in damages.

The court may even restrain alteration where it is likely to cause a damage which cannot be adequately compensated in terms of money. The facts of *British Murac Syndicate Ltd. v Alperton Rubber Co*. [1915:2:Ch.186] involved a situation of this kind.

An agreement provided that so long as the plaintiff syndicate should hold 5,000 share in the defendant company, it should have the right of nominating two directors on the board of the defendant company. A provision to the same effect was contained in Article 88 of the defendant company's articles. The plaintiff syndicate had nominated two persons as directors whom the defendant company refused to accept. An attempt was then made to cancel Article 88, but an injunction was granted to restrain it. The contract clearly involved as one of its terms that Article 88 was not to be altered, that is, that the plaintiff syndicate so long as it held the stipulated number of shares, was to have a perpetual right of nominating two directors of the company.

(c) Increasing Liability of Shareholders

An alteration cannot require a shareholder to purchase more shares or increase his liability in any way except with his consent in writing.

(d) Fraud on Minority Shareholders

Lastly, the alteration must not constitute a "fraud on the minority". The basic requirements are that the power of alteration must be exercised in good faith in the interests of, and for the benefit of, the company as a whole and also fairly as between different classes of shareholders. *Mutual Life Insurance Co.* of *New York v Rank Organization,* 1995 BCLC 11.

(e) Bonafide & For the Benefit of the Company

The alteration must be made bona fide for the benefit of the company as a whole: that is, it should not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the minority holders are deprived. Shuttle worth v. Cox Bros & Co [Maidenhead) Ltd. [(1927) 2 KB 9]. The articles of a company provided that S and V other should be the permanent directors of the company. They could however be disqualified by any of the six events. S failed to account for the company's money on 22 occasions within 12 months. The Articles were accordingly amended to include a 7^{th} event to disqualify. The event added was if a director was so requested in writing by all the other directors he should resign. S was so requested to resign. Held the alteration was bona fide for the benefit of the company as a whole and was valid. In Sidebottom v Kershaw Lease Co. Ltd, the directors held a majority of shares in a private company. The company altered its Articles so as to give power to the directors to require any shareholder who competed with the company's business to transfer his shares, at their full value, to the nominees of the directors. S held a minority of the shares and was in competition with the company. Held the alteration was valid as it was made bona fide for the benefit of the company.

(f) Must not Sanction Anything Illegal

The alteration must not purport to sanction anything which is illegal.

(g) The Court Has no Power to Alter Articles

Articles can be amended by a special resolution only of the company. The court may give direction to the company to alter the articles or restrain the operation of any amendment. As per section 21 of the Act, where an order is issued by the court to fully or partly void the decision made by the company to amend its objectives, the company shall not be entitled to amend its memorandum of association or articles of association in that matter without permission of the court or in a manner contrary to the order of the court.Where the memorandum of association or articles of association of a company is altered by an order of the court or the amendment made by the company is fully or partly endorsed by the court, such alteration or endorsement shall be enforced as if such alteration or endorsement were made by the general meeting of the company on its own.

6 DOCTRINE OF ULTRA VIRES AND INDOOR MANAGEMENT

Ultra vires is a Latin expression which lawyers and civil servants use to describe acts undertaken beyond *(ultra)* the legal powers *(vires)* of those who have purported to undertake them. In this sense, its application extends over a far wider area than company law. For example, those advising a Minister on proposed subordinate legislation will have to ask themselves whether the enabling primary legislation confers vires to make the desired regulations.

One consequence of the artificial nature of a company as a legal person is that inevitably decisions for, and actions by, it have to be taken for it by natural persons. Decisions on its behalf may be taken either (a) by its primary organs (the board of director or the shareholders in general meeting) or (b) by officers, agents or employees of the company; acts done on its behalf will perforce be by (b). In either event, a question may arise as to whether the decisions or acts have been taken or done in such a way that they can be attributed to the company.

Principles of Agency

The normal principles of vicarious liability and agency apply to the action of Corporate Board in this regard. The relevant principles can be summarized as follows:

(i) A principal is bound by the transactions on his behalf of his agents or employees, if the latter acted withineither the actual scope of the authority conferred upon them by their principal prior to the transaction or by subsequent ratification; or the apparent (or ostensible) scope of their authority.

(ii) A principal, *qua* employer, may also be vicariously liable in tort for acts of his employees or agents which, though not authorized, are nevertheless within the scope of their employment but, in general, is not criminally liable for their acts.

(iii) Obviously, application of these principles is more complicated when the principal is a body corporate which cannot confer authority on agents or employees except through the action of natural persons who constitute its organs or agents.

(iv) In its application to bodies of persons, ultra vires is habitually used in three different senses which ought to be kept distinct. When used in the strict sense, essentially what is in question is whether the body as such has capacity to act.

(v) Nevertheless, in the nineteenth century the *ultra vires* doctrine in this first sense was applied to companies registered undercompanies' legislation. However, even if a registered company is acting within its capacity, a second and further question can arise, which is whether those who purported to act on it behalf were authorized to do so in accordance with the normal agency principles summarized above. Although the basis of the law here is the general law of agency, those rules applied to companies in a somewhat special way because of the doctrine of constructive notice.

(vi) The third category of case, we must briefly mention arises from the fact that the courts sometimes describe as *ultra vires* any activity which a company cannot lawfully undertake, for example, because it infringes some prohibition laid down in the Act. Recent cases in England in which this has been done are perhaps understandable, for they have involved the prohibition on a company returning its capital to its shareholders. The competing explanation of the company's conduct in those cases was that it was simply exercising a power conferred upon the company in its memorandum, for

example, to pay remuneration to directors or to sell the company's assets. In rejecting this alternative explanation, the court was thus in effect holding both that the act was illegal and that it was *ultra vires.* As far as *ultra vires* acts are concerned, the legislature has achieved the position that third parties, normally, need not be concerned whether their transaction with the company is beyond its capacity or not. However, questions of excess or lack of authority cannot be dispensed with so easily, otherwise companies might be held liable for the actions of plausible con-men who had no connection with the company at all (sometimes called *soi- distant*agents). Here the legislature has concentrated instead on reducing (but so far not eliminating) the impact upon an agent's authority of the fact that he or she has acted in breach of the terms of the company's constitution.

The Development of the Ultra Vires Doctrine

In the landmark decision in *Ashbury Carriage Company v Riche* the House of Lords finally decided that it did. If a company, incorporated by or under a statue, acted beyond the scope of the objects stated in the statue or in its memorandum of association, such acts were void as beyond the company's capacity even if ratified by all the shareholders.

It was not, however, a decision that proved popular with the business world which, with the aid of its advisers, sought means of circumventing it. This was done by ensuring that the objects clauses of memoranda of association did not follow the succinct models in the Tables to successive Companies Act instead specified a profusion of all the objects and powers that the ingenuity of their advisers could dream up. The courts sought to narrow the scope of the resulting *vires* distinguishing between 'objects' (in the sense of types of business) and "powers" and, applying the *ejusdem generic* rule of construction, ruling that the powers could be used only in relation to the objects. But that too was circumvented by the device of ending the "objects" clause by stating that each of the specified objects or powers should be treated as independent and in no way ancillary or subordinate one to another, and, at a later date, by also inserting a power to carry on any other trade or business whatsoever which can, in the opinion of the board of directors, be advantageously carried on by the company in connection with or as ancillary to any of the above business or the general business of the company.

But all too often companies launched into new lines of business without realizing that changes in their objects clauses were needed and, as a result, wholly innocent people who had granted them credit might find themselves without a remedy. So might the company on contracts which it had entered into, for, as a crowning absurdity, it seems that, such contracts being void, not only could the incapable company not be sued but it could not sue the other party.

Constructive Notice

This second rule, established even before the strict *ultra vires* doctrine was held to apply, was that anyone dealing with a registered company was deemed to have notice of the contents of its "public documents" Precisely what that included was never wholly clear but it certainly included the memorandum and articles of association, thus introducing a further distinction between partnerships and companies. It meant that anyone having dealings with a company was deemed

to have knowledge of the content of its objects clause. In *Re Jon Beau forte (London) Ltd* [(1953):Ch.131 (where the insolvent company's stated objects were to manufacture dresses but it had for some time instead been making veneered panels) a combination of actual knowledge of the business being carried on by the company and of constructive notice of its stated objects resulted in all but one of its creditors 'claims being *ultra vires*. Even the claim of the supplier of heating fuel, who argued that this would have been needed whatever the company's business, was met by the answer that he had actual knowledge of the present nature of the business, since the fuel had been ordered on the company's notepaper which described it was "veneered panel manufacturers", and constructive knowledge that this was *ultra vires*. The result, therefore, of this constructive notice rule was that where the business being carried on by the company were known to third party and, whether he actually knew it or not, were *ultra vires*, he would be unable to sue the company.

The strict *ultra vires* doctrine in relation to companies should be abolished had long been recognized. The First Company Law Directive, Section 9(1) of the European Communities Act 1972 attempted to dispose of all the problems posed in two short subsections, the first of which provided that, in favor of a person dealing with a company in good faith, any transaction decided on by the directors should be deemed to be within the capacity of the company and the second of which relieved the other party of any obligation to inquire about those matters.

Abolition of Ultra Vires as Against Third Parties

Having attempted to simplify object clauses to make it easier to alter them, the second step taken to remove the consequences of exceeding any limitations on a company's capacity without actually admitting that it had full capacity. In 1989, the Companies Act of England wa samended. The amended section 35 of the English Act provided as follows: Sec35(1)"The validity of an act done by a company shall not be called intoquestion on the ground of lack of capacity by reason of anything in the company's memorandum".

Similar provision has been made in section 103(1) of the Companies Act, 2063, which is in *pari materia* with section 35 of the English Act, except for absolving under sub-section (3). Hence, if a company has entered into a contract which is beyond the powers of the company, but which as result of above Section 103(1) cannot be questioned on the grounds of lack of authority, the company cannot be restrained from performing the obligations under the contract.

The second qualification is made by sub-sec.(2) as follows: "(2) It remains the duty of the directors to observe any limitations on their powers flowing from the company's memorandum of association and actions by the directors which, but for sub-section(1) would be beyond the company's capacity may only be ratified by the company by special resolution. A resolution ratifying such action shall not affect any liability incurred by the directors or any other person, relief from any such liability must be agreed to separately by special resolution". Similar provision is contained in sec.103 (2), (3) and (4) of Nepal Companies Act.

Such provision is not found in the Indian companies Act. There in a winding up, only the court can decide the liability of directors for such acts exceeding the authority under sec. 543 and also

whether to punish them or to grant relief to them under sec.633 and the company cannot decide on the same.

Section 103(2) imposes a duty on the directors and officers to act within the jurisdiction provided in the memorandum. First it makes it clear that the directors are still under a duty to abide by the provision of the memorandum, even if third parties need not any longer be concerned with such restrictions. That duty is owed to the company and the company therefore can decide to sue the directors for failure to abide by the memorandum by a resolution in general meeting.

Second, the section empowers the shareholders to pass a ratification resolution which makes the transactions binding on the company. Under the common law, an *ultra vires* transaction can never be ratified even by the unanimous consent of all the shareholders.

Thus, the section of English Companies Act provides for two types of resolution, one to relieve the directors from liability to the company and the other to make the transaction binding on the company.

But the Companies Act. 2063 does not provide for relieving the directors or other persons of the company from liability for loss, if any, caused to the company by their *ultra vires* acts or due to exceeding their powers. But, the question is left open in company whether the shareholders by special resolution can relieve the directors or other persons of the company from liability.

Complementary provisions to the above are made in Chapter 12 relating to "Protection of shareholders interest". Under section 138, if any director or officer tries to do any act beyond their powers or jurisdiction, then any shareholder can file a petition in the court to stop such act. But they cannot stop the company from fulfilling their legal obligation arising out of the acts already agreed to be done. Under sec.140(1), the company may file case against any director, officers or the controlling shareholders or any person who acts in any way against the interest of the company. Under section 140(2), if the company does not file the case, then a single shareholder holding not less than 2.5% of the total shares or two or more than two shareholders holding not less than 5% of the total shares may file a case against any director or other offices or the controlling shareholders or any person who are trying to do any act against the interest of the company, This is in line with section 53(2) of English Act which states as follows: "(2) A member of the company may bring proceedings to restrain the doing of an act which but for sub-section(1) would be beyond the company's capacity, but no such proceedings shall be in respect of an act done in fulfillment of a legal obligation arising from a previous act of the company". Thus, the overall policy of protecting third parties legal rights is given priority to that of holding the company to its constitution.

Doctrine of "Indoor management"

The role of the doctrine of indoor management is opposed to that of the rule of constructive notice. The latter seeks to protect the company against the outsider; the former operates to protect outsiders against the company. The rule of constructive notice is confined to the external position of the company and, therefore, it follows that there is no notice as to how the company's

internal machinery is handled by its officers. If the contract is consistent with the public documents, the person contracting will be prejudiced by irregularities that may beset the indoor working of the company. The rule had its genesis in *Royal British Bank v Turquand.*

The directors of a company borrowed a sum of money from the plaintiff. The company's articles provided that the directors might borrow on bonds such sums as may from time to time be authorized by a resolution passed at a general meeting of the company. The shareholders claimed that there had been no such resolution authorizing the loan and, therefore, it was taken without their authority. The company was, however, held bound by the loan. Once it was found that the directors could borrow subject to a resolution, the plaintiff had the right to infer that the necessary resolution must have been passed.

In a subsequent case, the rule is thus stated: "If the directors have power and authority to bind the company, but certain preliminaries are required to be gone through on the part of the company before that power can be duly exercised, then the person contracting with the directors is not bound to see that all these preliminaries have been observed. He is entitled to presume that the directors are acting lawfully in what they do".

The rule is based upon obvious reasons of convenience in business relations. Firstly, the memorandum and articles of association are public documents, open to public inspection. But the details of internal procedure are not thus open to public inspection. Hence, an outsider "is presumed to know the constitution of a company; but not what may or may not have taken place within the doors that are closed to him". The wheels of commerce would not go round smoothly if persons dealing with companies were compelled to investigate thoroughly "the internal machinery of a company to see if something is not wrong". People in business would be very shy in dealing with such companies.

Yet another reason is explained by Gower in these words: "The lot of creditors of a limited company is not a particularly happy one; it would be unhappier still if the company could escape liability by denying the authority of the officials to act on its behalf".

The rule is of great practical utility. It has been applied in a great variety of cases involving rights and liabilities. It has been used to cover acts done on behalf of a company by *de facto* directors who have never been appointed, [*Mahony v East Holyford Mining Co,* (1875) 33 TLR 338, money withdrawn from company's banking account by *de facto* directors] or whose appointments is defective, or who, having been regularly appointed, have exercised an authority which could have been delegated to them under the company's articles, but never has been so delegated, or who have exercised an authority without proper quorum. Thus, where the directors of a company having the power to allot shares only with the consent of the general meeting, allotted them without any such consents where the managing director of a company granted a lease of the company's properties, something which he could do only with the approval of the board, where the managing agents having the power to borrow with the approval of directors borrowed without any such approval, the company was held bound by these acts. This principle has been incorporated in sec.106 of the Companies Act, where in it is provided that if any person acts as a director without knowing bona fide any irregularity or absence of authority to act as a director, shall be binding on the company.

Exceptions

The rule is now more than a century old. In view of the fact that companies having come to occupy the central position in the social and economic life of modern communities, it was expected that its scope would be widened. But the course of decisions has made it subject to the following exceptions:

(a) Knowledge of Irregularity

The first and the most obvious restrictions is that the rule has no application where the party affected by an irregularity had actual notice of it. "Thus, where a transfer of shares was approved by two directors, one of whom within the knowledge of the transferor was disqualified by reason of being the transferee himself and the other was never validity appointed, the transfer was held to be ineffective".

Knowledge of an irregularity may arise from the fact that the person contracting was himself a party to the inside procedure. In *Howard v Patent Ivory Manufacturing Co,* for example, the directors could not defend the issue of debentures to themselves because they should have known that the extent to which they were lending money to the company required the assent of the general meeting which they had not obtained. Similarly, in *Morris v Kansa*n a director could not defend an allotment of shares to him as he participated in the meeting which made the allotment. His appointment as a director also fell through because none of the directors appointing him was validly in office. The trend of decisions has been slightly altered by *Hely-Hutchinson v Brayhead Ltd,* according to which the mere fact that a person is a director does not mean that he shall be deemed to have knowledge of the irregularities practiced by the other directors. A newly appointed director entered into contracts of indemnity and guarantee with the company through a director whom the company had knowingly allowed to hold himself out as having the authority to enter intosuch transactions, although in fact he had no such authority. The new director had no knowledge of the irregularity. The company was held liable.

But apart from this, the principle is clear that a person who is himself a part of the internal machinery cannot take the advantage of irregularities. Any other rule would "encourage ignorance and condone dereliction from duty".

Company A lent money to Company B on a mortgage of its assets. The procedure laid down in the Articles for such transactions was not complied with. The directors of the two companies were the same. Held the lender had notice of irregularity and hence the mortgage was not binding. T.R. Pratt (Bombay) Ltd. v E.D. Sassoon & Co. Ltd [AIR1936: Bom: 62]

A transfer of shares in a company was approved by two directors. One of these directors was not validly appointed. The other was disqualified by reason being the transferee himself. These facts were known to the transferor. Held the transfer was ineffective. Devi Dutta Mal v. Standard Bank of India [AIR: 1927:Lah.797].

The directors of a company could borrow money up to £1000 without the approval of the shareholders in general meeting. The directors themselves lent the money in excess of the

borrowing powers of the company without the consent of shareholders at a general meeting. Held the directors had the notice of the internal irregularity and hence the company was liable to them only up to £1000 only. Howard v. Patent Ivory Co. [(1888) 38. Ch. D.156].

Knowledge of irregularity raises the question of 'Good Faith' as contained in section 104 of the companies Act, which more or less follows sec.35A of the English companies Act.

(b) Negligence- Suspicion of irregularity

The protection of "the *Turquand* rule" is also not available where the circumstances surrounding the contract are that suspicion should arise, for example, from the fact that an officer is purporting to act in a manner which is apparently outside the scope of his authority. Where, for example, the plaintiff accepted a transfer of a company's property from its accountant, the transfer was held void. The plaintiff could not have supposed, in the absence of power of attorney, that the accountant had authority to effect transfer of the company's property. Where a person holding directorship in two companies agreed to apply the money of one company in payment of the debt of the other, the court said that it was something so unusual "that the plaintiffs were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to makeit".Any other rule would "place limited companies without any sufficient reasons for so doing, at the mercy of any servant or agent who should purport to contract on their behalf".

(c) Forgery

Forgery may in circumstances exclude the *Turquand* rule. The only clear illustration is *Rubewn v Great Fingal Consolidated*.The plaintiff was the transferee of a share certificate issued under the seal of the defendant company. The certificate was issued by the company's secretary, who had affixed the seal of the company and forged the signatures of two directors.

The plaintiff contended that whether the signatures were genuine or forged was a part of the internal management and, therefore, the company should be estopped from denying genuineness of the document. But it was held that the rule has never been extended to cover such a complete forgery. Lord LOREBURN said: "It is quite true that persons dealing with limited liability companies are not bound to inquire into their indoor management and will not be affected by irregularities of which they have no notice". But this doctrine, which is well established, applies to irregularities which otherwise might affect a genuine transaction. It cannot apply to a forgery. This statement has been regarded as *dictum*, as the case was decided on the principle that the secretary did not have actual or implied authority to represent that forged document was genuine and, therefore, there was no estoppel against the company. Hence, a general statement that "the *Turquand* rule" does not apply to forgeries is not exactly warranted by the present authorities. Thus, for example, Andrews R. Thompson, writing in an extensive article on the subject, says: "A company may represent that a forged instrument is genuine. In such a case, it will be estopped from denying that a forged instrument is genuine as against an outsider who has relied to his detriment upon the representation. Also, a company may represent that the forger has authority to execute the forged instrument. In that event it will be bound by the forged

instrument as against an outsider who has relied on the apparent authority to execute the instrument".

In a case before the Madras High Court, a document on which a company borrowed a sum of money was executed by the managing director who was the chief functionary of the company and, to comply with the requirements of the articles, the signatures of two other directors were forged, the company was not allowed to eschew liability under the document [*Official Liquidator v Commr of Police,* (1969) 1 Com LJ 5 Mad].

"We hold the company liable as a matter of social and economic policy. The basis of liability is the eminently practical view that if authority is conditioned on facts peculiarly within the agent's knowledge, his representation express or implied should bind the principal".

(d) Representation through Articles

This exception deals with the most controversial and highly confusing aspect of "the *Turquand* rule". Articles of Association generally contain what is called the "power of delegation". *Lakshmi Ratan Cotton Mills v J.K. Jute Mills Co* explains the meaning and effect of a "delegation clause".

One G was a director of a company. The company had managing agents of which also G was a director. Articles authorized directors to borrow money and also empowered them to delegate this power to any one or more of them. G borrowed a sum of money from the plaintiffs. The company refused to be bound by the loan on the ground that there was no resolution of the board delegating the power to borrow to G. Yet the company was held bound by the loan."Even supposing that there was no actual resolution authorizing G toenter into the transaction, the plain tiff could assume that a power which could have been delegated under the articles must have been actually conferred. The actual delegation being a matter of internal management, the plaintiff was not bound to enter into that".

Thus, the effect of a"delegation clause",is"that a person who contracts with an individual director of a company, knowing that the board has power to delegate its authority to such an individual, may assume that the power of delegation has been exercised".

Suppose that the plain tiff when he contracted with an individual director had not consulted the company's articles and, therefore, had no knowledge of the existence of the power of delegation. Could he assume that the power of which he did not know at the time had been exercised? This question arose in *Houghton & Co. v Nothard, Lowe and Wills Ltd [(1927):1KB246]*.

The defendant company and one P & Co were engaged in fruit trade. One ML was a director of both companies. By the articles of the defendant company the directors could "delegate any of their powers to committees consisting of such member or members of their body as they think fit". ML acting on behalf of the defendant company, contracted with the plaintiffs, a firm of fruit brokers, that in consideration of the plaintiffs advancing a sum of money to P & Co, the plaintiffs should have the right to sell on commission all the fruit imported by the defendants and P & Co and to retain the sale proceeds belonging to both companies as security for the advance.

The plaintiffs required the confirmation of the agreement by the defendant company itself. The secretary of the defendant company accordingly wrote a letter confirming the agreement and then the plaintiffs made the advance. The defendants subsequently repudiated the agreement as made without their authority. In an action for the breach of the agreement, the plaintiffs claimed that *M L* or the secretary had ostensible authority as the board could have delegated their powers to them under the company's articles.

But it was held that the plaintiffs were not entitled to assume that any authority to make the contract had been delegated to them by the board, and this for the following reasons: Firstly, that "the plaintiffs are not entitled to rely on the supposed exercise of a power which was never in fact exercised and of the existence of which they were in ignorance at the date when they contracted, and secondly, that there was something so unusual in an agreement to apply the money of one company in payment of the debt of another that the plaintiffs were put upon inquiry to ascertain whether the persons making the contract had any authority in fact to make it". SARGANT LJ added that "even if the plaintiffs had known of the existence of the express power of delegation, they would not have been entitled to assume that it had been exercised in favor of *M L* or the secretary to any greater extent than was to be inferred from the position that they occupied or were held out by the company as occupying".

The Present Position

Sec. 35A (1) of English Companies Act provides "Infavor of a person dealing with a company in good faith, the powers of the board of directors to bind the company, or authorize others to do so, shall be deemed to be free of any limitation under the company's constitution". This is reflected in section 104(2) of the Nepal Companies Act, which states that if any person enters into any transaction in good faith with the company, such transactions shall be binding on the company. Any provision in the memorandum or Articles or in any resolution passed by the company or any agreement between any shareholder and the company shall not be deemed to have imposed any limitation or restriction on the directors or the authority of any authorized person to do such transaction. But section 104(1) provides that any transaction done, or any document signed, by any one director authorized by the company or a person authorized to act behalf of the company shall be binding on the company. Thus, the sting of the rule in RBS v. Turquand has been considerably watered down and except in case of fraud, the company will be liable for all the acts done by any authorized person on behalf of the company whether the other party had constructive notice of the limitations on the powers of the persons acting on behalf of the company or not so long as he acts in good faith. But as Nourse J said of the same "what it comes to is that a person who deals with a company in circumstances, where he ought anyway to know that the company has no power to enter into the transactions will not necessarily act in good faith. Sometimes, perhaps, often, he will not. And *a fortiari*, where he actually knows". *Barclays Bank Ltd. v.TOSG Trust Fund Ltd. [(1984) B.C.L.C. 1]* Finally the section creates a presumption of good faith and places the burden of showing bad faith on those who would wish to challenge the third party's bonafides.

But the proviso to section 104(2) provides that even though the transaction is binding on the company as far as the third party concerned, the director or the authorized person who exceeds his authority will be personally liable for the consequences of the transactions and the company

will not be liable unless the company adopts the same at the company's general meeting as provided in the Act. This section does not provide whether it should be ordinary resolution or special resolution. But since section 103(3) requires that such transaction should be approved by the general meeting by passing special resolution, in this case also the general meeting will have to pass a special resolution. But the director or any authorized person will further be liable to the company for any loss caused to the company by any such transaction. The general meeting adopting the transaction does not absolve the directors from their liability to the company, if any. Thus, the directors and any authorized person are discouraged from entering into transactions exceeding their powers. But in such case if the company does not take action against those directors or officers, then section 138 and 140 give rights to the shareholder to take action.

It may be noted that whereas section 103 tries to regularize the transaction exceeding the authority given by the Memorandum of Association, section 104 tries to regularize the transaction entered into by the director and officers beyond the authority delegated to them also.

7 PUBLIC OFFERING OF SECURITIES

Introduction

This chapter is concerned with a subject which is now rightly regarded as a branch of securities related law rather than company law. Nevertheless, it is a subject which the book on company law cannot ignore; students of that subject need to have some understanding of how public companies go about raising their share capital from the public and of the legal regulations that have to be complied with when they do.

Nevertheless, the dominating principle of the law is that the public who are offered company securities are entitled to full disclosure to them of the nature of what is on offer before they make a financial commitment, and to effective remedies to redress any loss incurred as a result of failure on the part of the company to make complete or accurate disclosure.

Although there is no legal obligation upon a company, to ensure that a market is available to the investors in its securities, on which they may subsequently trade the securities which they have obtained from the company, nevertheless it is obvious that a company which is aiming to raise large amounts of money will be able to do so more easily and at a better price if, after the "primary issue" of the securities by the company, investors have a "secondary market" upon which they may liquidate their investment when they so choose. It is the main purpose of the Stock Exchange to provide such markets.

Securities Act, 2063 gives the Securities Board of Nepal a general power to recognize 'investment exchanges' which meet the criteria of the Act and so permit them to operate in this country.

METHODS OF PUBLIC OFFERING

A company may have a choice of various methods whereby its securities can be offered to the public. In practice, it will normally engage the services of an issuing house (an investment bank)as sponsors of the issue and the method chosen will depend on their advice.

(a) Initial offers

On an initial public offering, a company's choice of method will be severely restricted. If the issue is of any size, it will have to proceed by way of an offer for sale for subscription followedby an introduction to listing. The company's finance director (and probably other executives) and representatives of the issuing house and of the company's and the sponsor's solicitors will work for weeks or months devote most of their time to working as a planning team. At a later stage, the services of one of the major merchant banks will generally be needed to handle applications and the preparation and dispatch of allotment letters. The offer will have to be made by a lengthy prospectus which will have to be published. To ensure that the issue is fully subscribed, arrangements will have to be made for it to be underwritten. Today, this is normally achieved by the sponsoring issuing house agreeing to subscribe for the whole issue and for it, rather than the company, to make the offer. In major offerings, such as the Government 's privatization issues, a syndicate of issuing houses may be employed. The issuing house(s) will endeavor to persuade other financial institutions to sub-underwrite. Ultimately, the cost of all this, including the commissions payable to underwriters and sub-underwriters, will have to be borne by the company.

"The nightmare of all concerned is that there will be an unforeseen stock-market collapse between the date of publication of the prospectus and the opening of the subscription list. The sweet dream is that the issue will be modestly over-subscribed and that trading will open at a small premium".

If the issue is over-subscribed, it will obviously be impossible for all applications to be accepted in full. The so called "offer" is normally not an offer (as understood in the law of contract) which on acceptance becomes binding on the offeror. It may in the case of a rights issue but an offer for sale is an invitation to make an offer which the issuer may or may not accept. Hence, the prospectus will need to say how that situation will be dealt with.

The company will probably wish to achieve a balance between private and institutional investors. To succeed in that aim, multiple applications by the same person will probably be expressly prohibited. Breaches are difficult to detect where applicants are made in different names but that abuse will doubtless become less common now in Europe that culprits have been successfully prosecuted. The decision that they had committed a criminal offence and not merely a breach of contract was something of a surprise both to them and others. Recently in India, the person making multiple applications in different names was caught and fined heavily by the Security Exchange Board of India.

The offer price is normally stated as a fixed and pre-determined amount per share. The Companies Act, 2063 Section 27(2) provides that the face value of shares of a public company

shall be Rs.50 or higher amounts divisible by 10. The offer price can however, be determined under a formula stated in the offer or applicants can be invited to tender on the basis that the shares will be allocated to the highest bidders. This, however, is rarely used in relation to issues of company securities. Nevertheless, a variation of it became popular in the early 1980s. Under this, a minimum price will be stated and applicants invited to tender at or above that price, an issue price then being struck at the highest price which will enable the issue to be subscribed in full, all successful applicants paying the same price, and those applicants who tendered below the striking price being eliminated. Recently in India, the book building process was adopted for the issues during 2006-07. The prospectus does not quote a single price but a range of maximum and minimum prices. Those applicants who pay the higher offer price will be allotted first and then the next lower and so on. If the higher price offering applicants are more, the lesser price offering applicants will not get any allotment of shares. This, however, did not prove to have advantages expected of it and is now seldom used though it still has its advocates.

Obviously, the expense of an offer for sale and subsequently introduction to listing is prohibitive unless a very large sum of money is to be raised. The Stock Exchange was concerned about this and made changes to the listing rules, allowing greater use of an alternative method known as a "placing".

Under this method the sponsor obtains firm commitments, mainly from its institutional investor clients (instead of advertising an offer to the general public) coupling this with an introduction to listing.

Another way of proceeding is the "intermediaries offer",defined as "a marketing of securities by means of an offer by, or on behalf of, the issuer to intermediaries for them to allocate to their own clients". This way of proceeding should be only marginally more expensive than a straight forward placing, but has the advantage that it is more likely to result in a wide spread of shareholders and a more active and competitive subsequent market.

(b) Subsequent Offers

Once a company has made its initial public offering, it will have additional methods whereby it can raise further capital. Even if it proceeds by an offer for sale, this will be less expensive if the securities issued are of the same class as those already admitted to listing. More often, however, it will make what is called a "rights issue" and, if it is an offering of equity shares for cash, it will generally have to do this unless the company in general meeting otherwise agrees. This is because of the pre-emption provisions of Section 56(7) and 56(11) of the Companies Act. The object of those provisions is to protect the existing shareholders from having their aliquot share of the equity diluted without their consent. Hence, the sections require that they be offered pre-emptive rights to subscribe in proportion to their existing holdings.

The practice is to make a rights issue at a price which represents a discount (often substantial) to the quoted price of the existing shares in the market, thus increasing the likelihood that the rights will be taken up either by the existing shareholders or by those to whom they have renounced their rights. Nevertheless, it is customary for the issue to be underwritten, not only to guard against the risk of a market crash but also because there will always be some shareholders who,

out of apathy or because they have moved from their registered addresses or because the rights are being quoted at a minimal or no premium, have neither taken up nor renounced their rights.

In one sense, a rights issue is considerably less expensive than offer for sale; circulating the shareholders is cheap in comparison with publishing a lengthy prospectus in national newspapers and mounting a sales pitch to attract the public. But in another sense, it may be dearer; if the issue price is deeply discounted. The company will have to issue far more shares (on which it will be expected to pay dividends) in order to raise the same amount of money as on an offer.

Analogous to, but distinguishable from, rights issues are Open Offers. Under these, an offer is made to the company's existing security holders. *Pro rata* to their existing holdings, but not affording them rights to renounce. Such offers are less common than rights issues. Other methods of issue, which can be used in appropriate circumstances, include exchanges or conversions of one class of securities into another like convertible debentures, convertible Preference shares, issues resulting from the exercise of options or warrants, and issues under employee share-ownership schemes- though these will not necessarily raise new money for the company.

(c) Vendor Consideration Issues

Two other types of issue deserve mention. The first of these is a Vendor Consideration Issue, i.e. one made as consideration for, or in connection with, an acquisition of property. If the vendor is willing to take by way of consideration, an allotment of equity shares of the acquiring company, there will be no need to offer the existing equity shareholders the pre-emptive rights; the issue to the vendor is not for cash. When the vendor wanted cash and the acquiring company raised it by a new issue of equity shares without offering its shareholders pre-emptive rights. The *modus operandi* was a tripartite arrangement where by the vendor sold in consideration of an allotment of shares which a merchant bank then placed on behalf of the vendor who thereby received the desired cash. This had advantages for all the parties (the company because it made it easier for it to adopt merger accounting). And so long as the acquiring company did not have to increase its authorized capital and its directors had been given general authority to issue capital all this could usually be done without any reference to its members in general meeting. Approval may involve what is known as a "claw-back", arrangement. Under this, instead of the merchant bank placing the shares with its associates, it will first make what is known as a "Vendor Rights Offer" enabling the acquiring company's shareholders to take up their pro rata entitlement at the issue price.

Regulation of Public Issues

The legal regulation of offers by public companies of securities to the public falls into two main divisions. First, Chapter III of Securities Act, 2063 regulates public offerings of securities. Later on, after allotment, such securities to be listed on the Official List of the Stock Exchange for conducting stock exchange transaction.

Under the Companies Act 2063, no security can be offered to the public unless the Security is approved and registered by the Securities Board of Nepal and Office of Company Registrar

respectively. All public companies need not necessarily issue shares to the public. But, if it desires to offer its shares for public subscription, it shall prepare the prospectus, get it signed from all of its directors, approve from SEBON, register it at OCR and publish it before its offer of its security to the public [Sec. 23(1)].

The prospectus has to be signed by all the directors of the concerned company and should be submitted to the Securities Board of Nepal for its approval in accordance with securities related law in force [Section 23(2)]. Until the approved prospectus copy is submitted to OCR and get it registered, the prospectus cannot be published for inviting public subscription for share.

However, the bulk of the rules on listing are to be found, not in the Securities Board of Nepal itself but in the Listing Rules made by the Stock Exchange approved by Securities Board.The importance of the Listing Rules in the public offer process justifies a short discussion of their history. Initially, the content and enforcement of the Listing Rules was entirely a matter for the Stock Exchange, *i.e.* it was truly a matter for self-regulation. Even when the domestic company legislation began to regulate public offers, the exchange was able to continue with its self-regulatory approach because issues subject to the Exchange's regulation were exempted from the statutory controls (though, of course, the Exchange's self-regulatory approach was subject to the domestic legislature continuing its exemption). All this changed when the European Community began in the late 1970s to regulate the listing of securities in the cause of promoting a single financial market.

The process began with European Council Directive 79/279/EEC on the admission of securities to listing and continued with Council Directives 80/390/EEC on listing particulars and 82/121/EEC on the continuing information obligations of listed companies. These Directives have now been consolidated in Directive of the European Parliament and the Council Directive 2001/34/EC on the admission of securities to listing and on information to be published on those securities (hereafter the "Listing Directive") The directive required statutory regulation of the listing process, but Member States, although required to appoint a "competent authority" to exercise the necessary powers, could and in the case of the UK did appoint a Stock Exchange as the competent authority known in this country as "the UK Listing Authority" ("UKLA"). Thus, the Stock Exchange and the Listing Rules continued to have a central place in the regulatory structure, but now by way of delegated authority from the Government rather than on the basis of self-regulation. In the final act of this drama, with the demutualization of the Stock Exchange, the Exchange itself no longer wished to carry out these regulatory functions and in May 2000 the functions of UKLA were transferred to the Financial Service Authority (FSA) and that is the position reflected in the current law (the FSMA). The Stock Exchange still imposes some limited requirements in its own right (London Stock Exchange, *Admission and Disclosure Standards* (2000) so that admission to listing and admission to trading are, in principle, separate decisions. However, the Listing Rules (Para 3.14A) tie the two things together again by making admission to trading (though not necessarily on the Stock Exchange) a pre-condition for listing. Similar practices are followed in other capital markets also.

In NEPAL, Securities Board of Nepal has been established under the Securities Act 2063 to develop the Capital Market and to protect the interest of the investors in the security. For the

purpose, the Board has the powers to regulate the issue, purchase, sale, distribution and exchange of securities by regulating and managing the Stock Market, and the persons engaged in the Securities business.

Statement in Lieu of Prospectus

One of the great advantages of promoting a public company is that the necessary capital for business can be raised from the general public by means of public issue. This advantage is, however, enjoyed only by a public company. Subsequently, it may enlist its securities at Nepal Stock Exchange pursuant to Securities Act, 2063 for facilitating securities exchange. A listed company means a public company which any of its securities has listed in any recognized stock exchange (section 2(g)). A private company is, by its very constitution, prohibited from inviting monetary participation of the public [Section 10 (c)].

The process of issuing securities through a statement in lieu of prospectus is a kind of private placement. The other documents, namely, a copy of the statement in lieu of prospectus and application form, are not issued to the public in general. They are circulated among selected persons for their personal use and with no right to pass them on to others. This method is gradually slipping into the hands of banking and financial institutions. The functioning is in the name of book building process. Orders are collected from investment bankers and larger investors based on an indicative price. SEBI guidelines have been issued in India for the purpose. Even in the case of a public issue, operation through book building is allowed to the extent to which reservation in issues is permissible.

Offers of Securities

(a) The vetting of prospectuses

The purpose of vetting is to put the regulating authority in a position to assure itself that the information given in the prospectus is complete before it is published. Inevitably, given the time and resources available, the SEBON cannot concern itself with the accuracy of the information put forward by the company, except perhaps for glaring inaccuracies appearing on the face of the document. Nevertheless, the obligation upon the issuer to obtain the prior approval of the SEBON is, no doubt, a valuable discipline upon the issuer and its professional advisers. It should also be noted that sec. 115 of the Securities Act, 2007 protects the SEBON and its officers from liability in damages for acts and omissions in the discharge of the functions conferred upon them, so that it will be rare for the SEBON to be worth suing if the prospectus turns out to be incomplete or in accurate.

(b) Publication of prospectuses and other material

All the effort involved in drawing up a prospectus, having it approved by the SEBON and registered at OCR is, of course, simply a prelude to its publication when the securities are offered to the public. This matter is regulated by Chapter 3 of the Securities Registration and Issuance Regulation, 2073 which stipulates that publication involves making the prospectus available "in printed form and free of charge to the public in sufficient numbers to satisfy public demand" at the issuer's registered office and at the office of any paying agent of the issuer. The Companies Act requires publication of the prospectus in a national newspaper, though issuers

often do this in their own interest of publicizing the offer. On TV also, even if it is only "formal notice" stating that a prospectus has been published and where it is available to the public. More important for informing the public generally of the availability of the prospectus is the publication by the SEBON on its website of where it can be obtained. In addition, Section 23(3) of the Companies Act requires a copy of the prospectus to be delivered before publication to the Office of Company Registrar, a requirement which no doubt helps the registrar to keep a complete file on companies in corporated.

The information contained in the prospectus must bepresented in as easily analyzable and comprehensible a form as possible‖, there is in fact a growing divergence between, on the one hand, the goal of providing comprehensive information and, on the other, that of providing comprehensive information and of advancing the understanding of potential investors of the risk which they face. It is no doubt the case that for large, especially institutional, shareholders the two objectives largely coincide, since they have the resources to devote to an analysis of the extensive information now contained in prospectuses where the securities are to be listed. The comprehensive information contained in the prospectus is analyzed by professional advisers and by financial journalists, from whom its distilled essence may flow, though this cannot be guaranteed, into the minds of smaller investors. Section 23(1) of the Companies Act require that prospectuses be published and be made available to the public, but they do not require them to be placed in the hands of the investor before he or she invests, not that, even if this does happen, that the prospectus be read and understood before the investment decision is taken.

For many retail investors, it is the advertisements issued in advance of the public offer, often in the form of a pathfinder prospectus, and the mini-prospectus issued at the time of the offer which provide the information for their decisions, together with some more or less well-informed newspaper comment. For them, the effective regulation of these documents is more important than increasingly complex full prospectus.

(c) Admission to and maintenance of listing

If any public company has allotted securities to the public, it may further enlist such securities to the Nepal Stock Exchange (NEPSE) for facilitating securities exchange among investors. The procedure for dealing with applications for listing and subsequent discontinuance or suspension of listing, however, is set out, at least in broad outline, in the statute. The overall picture is that the SEBON is given a broad statutory discretion over these matters, but subject to a right to challenge Authority's decision. The application is normally made by the issuer in question. Though the Act does not in fact insist on this, the consent of the issuer to the application is a pre-condition for admission, so that, for example a large shareholder cannot make an application for listing if the company does not wish it.

The Authority may discontinue listing, if it is satisfied that there are special circumstances which preclude normal regular dealings in them. It may also suspend the listing of securities, without limitation of grounds, though it must do so in accordance with the provisions of the Listing Rules. In either case, notice must be given in advance to the issuer and the Authority must take into account representations the issuer may wish to make.

(d) Continuing obligations

In order to maintain their listing at NEPSE, companies are required not merely to continue to comply with the conditions necessary to secure admission to listing but to comply in addition with a wide range of further obligations relating to the way in which they conduct their business thereafter, especially in terms of the conduct of relations with their shareholders and the market more generally. They relate to such matters as preemption rights, share repurchases and reductions of capital, notification of director's interest and share dealings by directors, shareholder consent to large transactions, related-party transactions, as well as the more obvious matter of regular disclosure of financial information by listed companies.

The continuing obligations of listed companies constitute in effect an additional layer of regulation which applies to large public companies and which in many respects fills lacunae to be found in the statutory regulation of companies.

In England, issue of unlisted securities are governed by the regulation issued by Financial Service Authority (FSA).

Public Offer

A public offer is an offer made to "any section of the public, whether selected as shareholders or debenture holder of a body corporate, or as clients of the person making the offer, or in any other manner". There then follow many exemptions, of which only the more important will be mentioned here. However, it does not follow that a situation not falling within one of the exemptions is a public offer. The offer must be a public one before the exemptions become relevant though it is difficult to give firm advice on what is a non-public offer, if it does not fall within one of the exemptions. Exempted are offers to persons whose ordinary business activities involve "acquiring, holding, managing or disposing of investments (whether as principal or agent)". This so-called 'professionals" exemption will cover a wide range of fund-managers, insurance companies and broker-dealers and is presumably based on the premise that, as professionals, they do not need the aid of the law to assess the risks associated with particular types of security. However, it should be noted that there is another specific exemption for offers to a restricted circle of persons whom the offeror reasonably believes to be sufficiently knowledgeable to understand the risks involved in accepting the offer. This makes the point that a number of the exemptions overlap and that many of them constitute different ways of trying to identify those who can look after themselves and who thus do not need or, rather, should not be entitled to the protection of the Regulations. In the same vein are the exemptions for offerings "in connection with a bona fide invitation to enter into an underwriting agreement".

Thus, bonus issues of shares are excluded, as are, perhaps more questionably, offers confined to the employees of the company. Further tranches of shares of the same issue, where a prospectus has been produced, will not need a separate prospectus. It follows from the above that a considerable number of what are prima facie public offers fall outside the scope of the Public Offer.

Prospectus

Prospectus is defined by Section 2(36) of Indian Companies Act. "A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate". In essence, it means that a prospectus is an invitation issued to the public to take shares or debentures of the company or to deposit money with the company. As per section 2(m) of Companies Act 2063, "Prospectus" means a prospectus to be published by a company pursuant to Section 23

Any advertisement offering to the public shares or debentures of the company for sale is a prospectus. Application forms for shares or debentures cannot be issued unless they are accompanied by a prospectus.

In a Calcutta case, an advertisement was inserted in a newspaper stating: "Some shares are still available for sale according to the terms of the prospectus of the company which can be obtained on application". This was held to be a prospectus as it invited the public to purchase shares. The directors were accordingly convicted under Section 92(5) [now Section 60(5) for not complying with the discloser requirements of the Act]

Public Issue

The provisions of the Act relating to prospectus are not attracted unless the prospectus is issued. "Issued" here means issued to the public.What does or does not amount to an issue is a question of fact in each case and is not capable of exact definition. [The Indian Companies Act says in S2(22) that "issued generally" means, in relation to a prospectus, issued to persons irrespective of their being existing members or debenture-holders of the body corporate to which the prospectus relates. Section 67 says that no offer or invitation shall be treated as made to the public if it is not calculated to become available to persons other than addressee or is otherwise a domestic concern of the persons making and receiving the offer etc.] Nepal Companies Act does not define "issued". In Nash v Lynd it was held that "the term 'issue' is not satisfied by a single private communication".

The facts were that a document marked "strictly private and confidential" but in form a prospectus was prepared by the defendant, the managing director of a company. But the document did not contain all the material facts required by the Act to be disclosed. A copy of it along with application forms was sent to a solicitor who in turn sent it to the plaintiff.

It was held that this did not amount to an issue and accordingly the plaintiff's action for compensation for loss sustained by reason of the omissions was dismissed.

3000 copies of a document in the form of a prospectus were sent out and distributed among the members of certain gas companies only, it was held to be an offer of shares to the public. [South of England Natural Gas and Petroleum Co. Re, (1911) 1 Ch 573:104 LT 378]. Section 67(1) of the Indian Companies Act also provides that in the context of offering shares or debentures to the public or invitation to the public [South of England Natural Gas and Petroleum Co.Re, (1911) 1 Ch 573:104 LT 378] to subscribe for shares or debentures, the term 'public' includes any section

of the public, whether selected members or debenture-holders of the company concerned or as clients of the person issuing the prospectus or in any other manner.

In the following cases, however, although shares are offered and application forms issued, a prospectus containing all the details is not necessary under the Indian Companies Act.

1. Where the offer is made in connection with a *bona fide* invitation to a person to enter into an underwriting agreement with respect to the shares or debentures;
2. Where the shares or debentures are not offered to the public;
3. Where the offer is made only to the existing members or debenture holders of the company;
4. Where the shares or debentures offered are in all respects uniform with shares or debentures already issued and quoted on a recognized stock exchange. [S56(5)(a) and(b)];
5. Where a prospectus is issued as a newspaper advertisement, it is not necessary to specify the contents of the memorandum, or the names etc., of the signatories to the memorandum or the number of shares subscribed for by them. [S.66].

Section 30 of the Securities Act, 2063 exempt the following issue of securities also from publishing a prospectus:

(a) Securities issued by Nepal Rastra bank;
(b) Securities issued with full guarantee of the Government of Nepal;
(c) Securities intended to be sold to a maximum of 50 persons at a time;
(d) Securities issued to employees and worker;
(e) Securities approved by Securities Board of Nepal to be issued without a prospectus.

Contents of Prospectus and Formalities of Issue

"The investor wants a sound concern". Prospectus is one of the means by which he is informed of the soundness of the company's venture. That indeed is the basic function of the prospectus. But this fact also affords an opportunity to directors and promoters to impose a fraud on the public. The Companies Act accordingly now contains a comprehensive set of regulations intended to protect the investing public form such victimization. The chief aim of the Legislature in making these regulations, is to secure the fullest disclosure of all material and essential particulars and lay the same in full view of the intending purchasers of shares. The relevant rules and regulations are briefly set out below:

1. Every prospectus to be Dated [Section 55] Indian Companies Act

Every prospectus has to be dated. This ensures a *prima facie* evidence of the date of its publication. [The date of issue is important to very many things connected with the prospectus, for example, pricing of the issue is related to the value of the proffered securities to the timing of the issue. The date mentioned on the prospectus, unless the contrary is proved, is taken as the date of publication of prospectus. (S.55)] Section 23(7) of Companies Act, 2063 provides for the date approved by the Securities Board of Nepal and registered by the Office of Company Registrar.

2. Every Prospectus to be Registered [Section 60] Indian Companies Act

A copy of every prospectus has to be registered with the Registrar of Companies. This preserves an authoritative record of the terms and conditions of the capital issue. Registration must be made on or before the publication of the prospectus. The copy sent for registration must be signed by every person who is named in the prospectus as a director or a proposed director of the company. The copy for registration must be accompanied with:

(a) if a report of an expert is to be published, consent of the expert; [S.60(1)(a)],
(b) a copy of every contract relating to appointment and remuneration of managerial personnel; [S. 60(1)(b), Sch II, clause 16],
(c) a copy of every material contract, unless it is entered into in the ordinary course of business or two years before the date of the prospectus,
(d) a written statement relating to the adjustments, if any, 'as respects the figures of any profits or losses or assets and liabilities', dealt with in any report set out in the prospectus in pursuance to Part II of Schedule II. The statement should give reasons for the adjustments and be signed by an expert,
(e) the consent in writing of the person, if any, named in the prospectus as the auditor, legal advisor, attorney, solicitor, banker or broker of the company, to act in that capacity. [S.60(3)].

The prospectus must be issued within ninety days of its registration. But no such provision is in Nepal Companies Act. The company and every person who knowingly issues a prospectus without registration is punishable with a fine which may extend up to fifty thousand rupees. It must be stated on the face of the prospectus that it has been registered and that the requisite documents, giving names, have been filed. [S 60(2) (a)(b)] Indian Companies Act

The Registrar is under duty not to register a prospectus which does not comply with the requirements of sections 55, 56, 57 and 58 and 60(1) and (2) of Indian Companies Act and which does not contain the consent in writing of the person, if any, named in the prospectus as auditor, legal adviser, attorney, solicitor, banker or broker of the company. The consent should be his acceptance to act in that capacity. Section 61 provides that the contracts which are referred to in the prospectus or in a statement in lieu of it, are not to be varied unless the variation is approved by the company in general meeting or made under its authority.

3. Expert's Consent [Section 58] Indian Companies Act

If the prospectus includes a statement purporting to be made by an expert, consent in writing of that expert muse be obtained and this fact should be stated in the prospectus. The expert should not be one who is himself engaged or interested in the formation, promotion or management of the company. He should be unconnected with the formation or management of the company. This section enacts a wholesome rule intended to protect an intending investor by making the expert a party to the issue of the prospectus and making him liable for untrue statements.

As per Companies Act 2063, the matters to be set out in the prospectus shall be as mentioned in the prevailing law on securities. Further, Companies Act Section 24 provides for the liability of directors only and not of the experts whose opinion is incorporated in the

prospectus. But Section 33 of the Securities Act, 2063 makes the experts also liable for the matters prepared by them included in the prospectus.

4. Disclosures to be Made

Securities Board of Nepal has issued a Securities Registration and Issuance Regulation, 2073 for the preparation of Prospectus under the Securities Act, 2063.

Sec. 56(Indian Companies Act) requires every prospectus to disclose the matters specified in Schedule II of the Act. The schedule is divided in the three parts. Part I contains the matters to be specified, Part II, the reports to be set out, while Part II is explanatory of Part I and II.

Part I

This part has to disclose some general information, capital structure of the company, terms of the present issue, particulars of the issue, company management and project particulars in regard to the company and other listed companies under the same management which made any capital issue during the last three years, information about certain pending litigation, management perception of risk factors e.g., sensitivity to foreign exchange rate fluctuations, difficulty in availability of raw materials, or in marketing of products, cost-time overrun, etc.

Part II

This part has to carry some general information and financial information in terms of reports relating to profits and losses and assets and liabilities of the company. Report under the Indian Companies Act must refer to the rates of dividends, if any, paid by the company in respect of each class of shares for each of the five financial years before the issue of the prospectus. The report of the auditors must also state separately the profits and losses of the company's subsidiaries and also combined profits and losses. If the company proposes to acquire any business, a report should be made by an accountant, whose name should be disclosed, upon the profits and losses of the business for five years before the date of the prospectus and assets and liabilities of the business. This part has also to carry disclosures as to utilization of proceeds of the issue and some statutory and other information.

Part III

This part offers some explanations about the contents of Part I and II.

SEBON regulation does not require any audited accounts or auditors report to be included in or attached with prospectus. As compared to the Indian Companies Act, which requires the accounts for previous five years to be disclosed, SEBON Regulation requires the accounts for previous three years only. Indian Companies Act requires that if any dividend had been declared in the previous five years, the same should be certified by the auditor but not the SEBON regulation.

5. Shelf Prospectus [Section 60-A] of Indian Companies Act

Filing of a shelf prospectus has been made compulsory for any public financial institution, public sector bank, or a scheduled bank whose main object is financing. The advantage to the filing

company is that it shall not have to file a prospectus every time it issued securities within the period of validity of such prospectus. The meaning of a shelf prospectus (like information contained in a file lying on a shelf) is confined to a prospectus issued by financial institutions or banks. A company filing such prospectus is also required to file an information memorandum on all material facts relating to new charges created, changes occurring in the financial position in the period from first offer of securities, previous offer of securities and the succeeding offer within such time as may be prescribed by the Central Government prior to the making of a second or subsequent offer of securities under the shelf prospectus. The information memorandum has to be issued to the public along with the shelf prospectus at the stage of first offer of securities. The prospectus remains valid for one year from the date of opening of the first issue of securities. Where an update of the information is filed every time an offerof securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus. Financing means making loans to or subscribing to the capital of a private industrial enterprise engaged in infrastructure financing or such other company as the Central Government may notify for this purpose.

6. Information Memorandum [Section 60-B] Indian Companies Act

Consequent upon introduction of a new variety of prospectus, namely, shelf or red-herring prospectus, the concept of 'information memorandum' has been defined in Section 2(19-B) by the Amendment Act of 2000. It is as follows: "Information memorandum means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities are assessed by means of a notice, circular, advertisement or document".

A public company making an issue of securities may circulate an information memorandum to the public prior to the filing of a prospectus. A company which invites subscription by means of an information memorandum has to file a prospectus prior to the opening of the subscription list and the offer as a red-herring prospectus, at least three days before the opening of the offer. The information memorandum and the red-herring prospectus carry the same obligations as are applicable to a conventional prospectus. The issuing company has to highlight any variations between the information memorandum and the red-herring prospectus. For the purposes of the provisions contained in first four sub-sections of Section 60-B a red-herring prospectus means a prospectus which does not offer complete information on the price and the quantum of the securities proposed to be issued [S. 60-B (4) [Explanation].

Variations must be individually intimated to the persons invited. Where payment has been received in advance by means of drafts, cheques, etc., they shall not be encashed without first individually intimating to the prospective subscribers the fact of the variations and without giving them an opportunity to withdraw their applications. Applications may be withdrawn within seven days of the intimation of the variation. If any allotment is made without complying with this requirement it is void. The applicants shall be entitled to be paid back their subscription money with 15% interest.

On completion of allotment and closing of the offer of securities, a final prospectus has to be prepared completing the information which was missing in the red-herring prospectus, namely,

the amount of capital raised whether by way of debt or share capital, the closing price of the securities, etc. Such prospectus has to be filed with SEBI in the case of a listed public company and with the Registrar in other cases.

7. Issuing Houses and Deemed Prospectus (Section 64) Indian Companies Act

"Provision relating to prospectus are most stringent and the duty of preparing and filing it in accordance with the law is extremely onerous. But these onerous requirements were often evaded by companies in this way.Thewhole of the capital of a company was allotted to an intermediary known as an "Issuing House". The "House" then offered the sharesto the public by means of an advertisement of its own, which was obviously not a prospectus and thus the requirements of the Act relating to prospectus were evaded. But now every such advertisement sponsored by an "Issuing House" is known as an "offer for sale" and is deemed to be a prospectus issued by the company. The responsibility of the company, its directors and promoters is, therefore, the same. In addition, the "Issuing House" incurs its own liability. [Section 54(1)]

To ascertain whether an agreement to allot shares to an "Issuing House" is intended for the shares to be offered to the public, apart from the express provisions of the agreement, the Act provides in Section 64(2) that the intention to offer shares to the public shall be presumed in the following cases:

1. Where the "Issuing House" offers the shares to the public for sale within six months after they were allotted or agreed to be allotted to the House;or
2. Where at the date of offer to the public, the whole of the consideration to be received by the company in respect of shares has not been received.

The prospectus issued by "Issuing House" shall state following further particulars: [(S.69 (3)]

1. Net amount of consideration to be received by the company in respect of those shares, and
2. Place and time at which relevant contracts may be inspected.

8. Disclosure Should Give True and Fair View of Company's Position

Above all, the golden rule as to the framing of prospectus must be observed. The rule was laid down by KINDERSELY VC in New Brunswick and Canada Rly and Land Co v Muggeridge [(1860) 3 LT 651:30 LJ Ch 242] and was described as a golden legacy by PAGE WOOD VC in Henderson v Lacon [(1867): 17 LT 527:59 LJ Ch 794:5 Eq249].

Briefly, the rule is this: "Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking. Public is invited to take share on the faith of the representations contained in the prospectus. The public is at the mercy of company promoters. Everything must, therefore, be stated with strict and scrupulous accuracy. Nothing should be stated as fact which is not so, and no fact should be omitted the existence of which might in any degree affect the nature or quality of the privilege and advantages which the prospectus holds out as inducement to take shares. In a word, the true nature of the company's venture should be disclosed".

REMEDIES FOR MISREPRESENTATION

1. Damages for Deceit

Deceit is a tort. It means fraud. Anyone who has been induced to invest money in a company by a fraudulent statement in a prospectus can sue the persons responsible for issuing it. If his action is successful he recovers full compensation for the loss sustained by him directly as a result of the fraud.

(a) Fraudulent mis-statement

In the first place, the plaintiff must prove that there was a fraudulent misstatement. 'To support an action of deceit', said Lord HERSCHELL, "fraud must be proved and nothing less than fraud will do". Fraud is proved when it is shown that false representation has been made:

(i) Knowingly, or
(ii) Without belief in its truth, or
(iii) Recklessly, carelessly whether it be false or true.

In other words, if the directors publish a statement with knowledge that it is false or without any knowledge, whether it is true or false, it is a fraud. Fraud maybe committed by reckless representations without knowing how the matter stands one way ortheother.Section 17 of the Indian Contract Acts defines 'fraud'as including, among other things, the suggestion that a fact is true when it is not so and the person making the suggestion does not believe it to be true and the active concealment of a fact. These definitions show that if the person making the statement honestly believes it to be true, he is not guilty of fraud, even if the statement is not true. *Derry* v *Peek* [(1889) 14 AC 337:1886-90) All ER Rep 1] involved a situation of this kind.

A special Act incorporating a tram-way company provided that carriage might be moved by animal power and, with the consent of the Board of Trade, by steam power. The directors issued a prospectus containing a statement that by their special Act, the company had the right to use steam power instead of horses and that a saving would be effected thereby. No reference was made to the Board of Trade who refused their consent. Consequently, the company had to be would up. The plaintiff having taken shares on the faith of the statement brought an action of deceit against the directors. But they were held not liable.

The statement was certainly untrue because the power to use steam was stated to be an absolute right, when in truth it was conditional on the approval of the Board of Trade. But the directors honestly believed that once the Act of Parliament had authorized the use of steam the consents of the Board of Trade was practically concluded.

(b) Representation relating to fact

Secondly, the false representation must relate to some existing facts which are material to the contract of purchasing shares. The purposes for which the new money is going to be used is an important fact. In Edgington v *Fitzmaurice,* [(1885) 29 Ch D 459:1885) 53 LT 369] for example:

The directors of a company issued a prospectus inviting subscriptions for debentures and stating that the objects of the issue of debentures were to complete alterations in the buildings of the

company, to purchase horses and vans and to develop the trade of the company. The real object of the loan, however, was to enable the directors to pay off pressing liabilities. Relying upon the statement the plaintiff advanced money. The company became insolvent and the plaintiff sued the directors for fraud.

The directors argued that the suggestion of possible purposes to which the money might be applied was not a statement of existing facts. But they were held liable. BOWEN LJ said that the directors had misrepresented their state of mind and 'the state of man's mind is as much a fact as the state of his digestion'. The statement was also regarded as material to the contract. A man who lends money reasonably wishes to know for what purpose it is borrowed, and he is more willing to advance it if he knows that it is not wanted to pay off liabilities already incurred. *S. Chatterjee v T.B. Sarwate,* AIR 1960 MP 322]

(c) Remedy of direct allottees

Thirdly, the plaintiff should have taken the shares directly from the company by allotment. "Those only who are drawn in by the misrepresentation in the prospectus to become allottees can have a remedy against the directors". [Peek v Gurney, (1873) 43 LJCh 19: (1861-73) All ER Rep 116: LR 6 HL 377] A purchaser of shares in the open market has no remedy against the company or the promoters though he might have bought on the faith of the representations contained in the prospectus. This rule owes its origin to *Peek v Gurney*. [(1873) 43 LJ Ch 19: (1861-73) All ER Rep 116: LR 6 HL 377].

Adeceitful prospectus was issued by the defendants on behalf of a company. Th eplain tiff received a copy of it but did not take any shares originally in the company. The allotment was completed and several months afterwards the plaintiff bought 2000 shares on the stock exchange. His action against the directors for deceit was rejected. 'The office of a prospectus', the Court said, is to invite persons to become allottees, and, the allotment having been completed, such office is exhausted and the liability to allottees does not follow the shares into the hands of subsequent transferees. Directors cannot be made liable and *ad infinitum* for all the subsequent dealing which may take place with regard to those shares upon the stock exchange. [Similar is the position of a person in whose favor shares were renounced.

This principle has been recognized in the Securities Registration and Issuance Regulation, 2073 to state in the prospectus that the issue price has no relevance to the subsequent market price of shares.

(d) Buyers in secondary market

But'where the object with which the prospectus of a company is issued is not merely to induce applications for allotment of shares, but also to induce persons to whom it is sent to purchase share in the market, its function is not exhausted when the company has gone to allotment, and the person issuing the prospectus is responsible for the consequences of false representation contained in it'. In other words, 'there must be something to connect the directors making the representation with the party complaining that he has been deceived and injured by it, as, for example, where the fraudulent prospectus is delivered to a person who there upon becomes a

purchaser of shares'. This principle found application in *Andres v Mackford.* [1896 1 QB 372: (1896) 73 LT726]

The defendants sent to the plaintiff a prospectus of a company which they know would be a sham or pretended company in order to induce the plaintiff to purchase shares therein. The plaintiff did not then do so. The prospectus, having produced but a scanty subscription for shares, the defendants thereupon fraudulently published a telegram in a newspaper. The plaintiff believing in the truth of the telegram was induced to purchase shares in the open market. The directors were held liable for the systematic fraud.The function of the prospectus was not exhausted, and the false telegram was brought into play by the defendants to reflect back upon and countenance the false statements in the prospectus.

Further, by reason of the decision of the House of Lords in *Hedley Byrne & Co. v Heller & Partners Ltd*, [(1963) 3 WLR 101: (1963) 2 All ER 575:1964 AC 465]a person may become liable for holding out a false statement to anyone whom he knew or ought to have known would act in reliance upon the statement.

Further developments in this respect have been noted in *Pussfund Custodian Trustee Ltd v Diamond* [(1996) 2 BCLC 665 Ch D and also Parr v Diamond, (1996) 2 BCLC 665 Ch D]. The prospectus here was for floatation of securities on the unlisted securities market. A majority of the complainants were original allottees and others were buyers in the open market (after-market purchasers). The company went into receivership. There were actions against the company for false statements in the prospectus. The company applied for striking out the claims of aftermarket purchasers. The court said that such purchasers would have to establish that they had reasonably relied on the representations made in the prospectus and reasonably believed that the representor intended them to act on the statements and that there existed a sufficiently direct connection between the purchaser and the representor to render the imposition of such a duty fair, just and reasonable. The wide publicity of a prospectus would go to show that the intention was to influence not only the first buyers but also subsequent market operations. The issue should, therefore, be tried on merits and was not to be struck out.

(e) Liability of company

The company may also be sued for damages provided that the fraud was committed by the directors within the scope of their authority. But the action against the company is beset with the limitation laid down by the House of Lords in *Houldsworth v City of Glasgow Bank*, [(1880) 5 App Cas 317: (1880) 42 LT 194 HL] that the contract of allotment must first be rescinded. One cannot remain in the company as a shareholder and yet sue it for damages. But sec 24(3) of the Companies Act make the directors signing the prospectus responsible and not the company.

2. Compensation under Section 62

The decision of the House of Lords in *Derry v Peek* exposed the inadequacy of the tort action of deceit to protect the interest of investors in public companies. The directors in that case had, no doubt, told their falsehood in good faith rather than from corrupt motive. But that would not console the misled investor for he is not concerned with the state of the directors'mind or

conscience. His loss is just the same whether the misrepresentation on innocent or fraudulent. The amount of compensation to the mislead investor is the value taken from him and the real value of the share. Normally, such loss can be ascertained to be the difference between the allotment value and the market value of the security. Accordingly, within a year of the decision in *Derry v Peek* the Directors'Liability Act, 1890 was passed in England and the directors were made answerable for false statements although they might have believed their assertions to be substantially true. The provisions of this Act have been re-enacted in Section 43 of the English Companies Act, 1948. Section 62 is the corresponding provision in the Indian Act. Following persons are liable under this section:

(a) Every person who is a director of the company at the time of the issue of the prospectus;
(b) Every person who has authorized himself to be named as a director in the prospectus;
(c) Every promoter who was a party to the preparation of the prospectus;
(d) Every person who authorized the issue of the prospectus.

Section 24(3) of the Companies Act, 2063 also states that the statement should have been made dishonestly or in bad faith or to be true knowingly to be false and as a result of such statement, if any person subscribing for the shares, incurs any loss due to such false dishonest statement, he shall be able to get compensated from the directors who have signed the prospectus. The loss should be a result of such dishonest or false statements made in the prospectus. SEBON Securities Registration and Issuance Regulation requires a statement to be made in the prospectus that the market price of the shares has no relation to the price at which the share are offered to the public under the prospectus.

They are liable to compensate the investor for any loss sustained by him by reason of any untrue statement contained in the prospectus. A statement is deemed to be untrue, if it is false in the form and context in which it is included. Omissions which are calculated to mislead shall also render the prospectus false. The liability is joint and several and the person who becomes liable may recover contribution from others equally guilty of misrepresentation. [S. 62(3) of Indian Companies Act.] An instance of liability under the section is provided by *Greenwood v Leather Shod Wheel Co.* [(1900) 1 Ch 421:1900) 81 LT595]

The prospectus issued by a wheel manufacturing company stated: "Offers have already been received (*inter alia*), from the House of Commons….. Wheels for the trolleys in the House of Commons have been ordered and are now in use". In fact no single order had been obtained except for trial and by way of experiment. It was held that the prospectus contained untrue statement.

If the representation is false, the directors cannot escape liability even if they had made it *bona fide* and not with intent to deceive. But they have the following special defenses under the section. [S. 62(2) Indian Companies Act] [Corresponding to Proviso to Sec.24(3)]

(a) Resignation from Director Post – A director shall not be liable if he resigns before the decision made by the company to publish the prospectus

(b) Issue without knowledge – Even where a director's name appears in the prospectus, he can escape liability by proving that it was issued without his knowledge or consent and on becoming aware he forthwith gave a public notice to that effect.

Securities Act, 2063 and its regulation requires that all the directors have to sign the prospectus and give a declaration that what all stated in the prospectus is true to their knowledge signed by all the directors. Therefore, this defense may not be available in Nepal.

(c) Ignorance of untrue statement – Sometimes a director may be ignorant of the untruth of the statements made in the prospectus. Such a director can defend himself by showing that, on becoming aware of the untrue statement, he withdrew his consent by a reasonable public notice. Obviously, this must be done before allotment. [Sec. 24(3) provision of Companies Act, 2063]

(d) Reasonable ground for belief – A director will also be protected if he can show that 'he had reasonable ground to believe, and did up to the time of allotment believe the statements to be true'. It is not enough for him to say that he was honest. He must go further and show that his honest belief was based upon reasonable grounds. And so in *Adams v Thrift*. An action was brought by the plaintiff to recover compensation from a director of a company in respect of false statements in a prospectus. The director contended that the statements were prepared by the promoters and before issuing he enquired from one of them, 'Is everything perfectly alright' and he said'of course, it is'.It was held that although the director did honestly believe the statements to be true, he had no reasonable ground to do so. The promoter is the very last person whose uncorroborated statement ought to be relied upon by an intending director as justification for saying that he had reasonable ground for belief. If they had taken the opinion or obtained a report of competent people as to material facts in the prospectus that might have afforded a reasonable ground for belief.

(e) Statement of expert – If the untrue statement happens to be contained in the report of an expert, the director sued has to show that he had reasonable ground to believe and did up to the time of allotment believe that the expert was competent, and if it is in some public official document, that it was a correct and fair representation of the document.

3. Rescission for Misrepresentation

An allotment of shares can be avoided at the option of the allottee if it was caused by misrepresentation whether innocent or fraudulent. By avoiding the contract, he is able to get rid of his shares and claim the money he paid for them.

(a) False

Sometimes an ambiguous statement is put forward bearing two different meanings, one of which is true and the other untrue. A case of this kind is *Smith v Chadwick.* The prospectus of a company which was being formed to take over certain iron works contained the statement that 'the present value of the turnover is £1,000,000 sterling per annum'. If the statement meant that the works had actually in one year turned out produce worth more than a million, it was untrue. If, on the other hand, it meant that works were capable of turning out that amount of produce, it was true. It was held that 'if they put forth a statement which they knew may beartwo meanings one of which is false to their knowledge and thereby the plaintiff putting that meaning on it is misled, they cannot escape by saying he ought to have put theother'. A misreading of the prospectus will not, however, entitle a purchaser of shares to rescission.

(b) Change of circumstances

There is often an interval of time between publication of a prospectus and the allotment of shares. During this interval, a statement which was true when made may cease to be so owing to some change of circumstances. For example, in *Rajggopala Iyer v South Indian Rubber Works.*

The plaintiff had applied for shares in a company on the basis of a prospectus containing the names of several persons as directors. But before the allotment took place, there were changes in the directorate, some directors having retired. That was held sufficient to entitle the plaintiff to revoke his application as few matters are more important than the name of directors. Moreover, the persons who applied for shares on the faith of one state of things should have the option of retiring when a totally different state of things came into existence.

(c) Of facts and not of law

Secondly, the misrepresentation must be of facts and not of law. If, for example, a prospectus represents that the company's fully paid shares will be issued at half their nominal price, when the Companies Act prohibits the issue of shares at so much discount, it is a misrepresentation of law and a person deceived by it will have no remedy. Again, the facts misrepresented must be material to the contract of taking shares. Materiality of misrepresentation is a question of fact in each case. Generally speaking, a fact is said to be material if it is likely to influence the decision of an average purchaser of shares, that is, if it will urge or induce him to purchase or refrain from purchasing shares. For example, in *Mckeown v Boundard Peveril Gear Co. Ltd.* [(1896) LT 310: 65 LJ Ch 735]

(c) Criminal liability for misrepresentation [Section 160(1)]

Where a prospectus includes any untrue statement, any director or officer who authorized the issue of the prospectus shall be punishable with imprisonment for a term not exceeding two years, or with fine from twenty thousand to to fifty thousand rupees or with both. A director prosecuted under this section can defend himself by showing that the statement was immaterial or he had reasonable ground to believe and did up to the time of the issue of the prospectus believe that the statement was true. A company's prospectus stated that the company had the experience in its line of business of two and a half decades. The experience was, in fact, that of the partners of a firm which had been taken over by the company and not that of the company itself. The court granted relief against any possible liability. There was no *mala fide* intention behind the statement. The management was successful. The statement was not so materially false as to invite prosecution. [*Progressive Aluminum Ltd v Registrar of Cos* (1997) 89 Comp Cas 147AP].

Under Indian Companies Act Sec.68 has made it a punishable offence to fraudulently induce persons to invest money in companies. The penalty of the section is attracted when investment is brought about by knowingly or recklessly making any statement, promise or forecast which is false, deceptive or misleading or by any dishonest concealment of material facts. Liability would be incurred even when one is only attempting to do so. Even attempt is punishable. The object of the inducement is to bring about any agreement for acquiring, disposing of or subscribing for or

underwriting any shares or debentures or bringing about profit from fluctuations in the value of shares or debentures. (Note: This has been covered under the Securities Act, 2063)

(d) Reliance and inducement

It is further necessary that the plaintiff should have acted in reliance on the statements contained in the prospectus. Misrepresentation should be at least one of the inducements for his contract of taking shares. It is for this reason that a purchaser of shares in the open market cannot proceed against the company unless the company had done something to induce him to purchase in the market. But a recipient of a prospectus is entitled to rely on it. He is not bound to verify it.

But it appears that when once it is established that there has been any fraudulent misrepresentation or willful concealment by which a person has been induced to enter into a contract, it is no answer to his claim to be relieved from it to tell him that he might have known the truth by proper inquiry.

(e) By or on behalf of company

"A company is not responsible for the statements in a prospectus unless it is shown that the prospectus was issued by the company or by someone with the authority of the company by the board of directors, for instance [Palmer's, Company Law, p 165 (20th Edn, 1959). See *Meta Con*stituents Ltd, Re, Lord Lurgan case, (1902) 1 Ch 707 : (1880) 86 LT 291, where a misrepresentation was made before incorporation and the company was held not liable], or that the prospectus, having been issued by the promoters was ratified by the company.

This becomes particularly important where a representation is made apart from prospectus. Thus, where a person was induced to join a company as a shareholder by representations of the secretary of the company, he could not obtain rescission as the secretary has no general authority to make representations.

8 PROMOTERS

The term "promoter" as defined in Sec. 2 (i) of the Companies Act, 2063 means the person who signs the Memorandum and Articles of Association to be filed with the Office of Company Registrar for the purpose of incorporating a company, agreeing to the matters mentioned in these documents in the capacity of promoters.

He should be the signatory to the Memorandum and Articles of Association. But the signature should be in the capacity of promoter. In the MOA and AOA, oa witness of each promoter also has to sign confirming the signature of the promoters but they are not considered as promoters, though they also sign on the MOA and AOA

Merely signing the MOA & AOA will not make a person a promoter unless those are filed with the OCR for the purpose of incorporating a company. If a person just signs as a promoter but the documents are not filed with OCR for incorporation of the Company, he cannot be legally deemed a promoter of the company.

Under Sec. 42(2) restrictions are imposed on the promoter in transferring or pledging his shares except in the case of a Private Limited Company which has not taken any loan from any other company including Banks, Finance Companies etc. If it has taken loan from an individual, this prohibition does not apply. Further, the amount called on the shares should have been fullypaid and the first general meeting should have beenheld.Both the conditions are to be satisfied. Hence, even after the first general meeting is held, if the call amount is not fully paid, then also the promoter cannot sell or mortgage his shares.

In the case of Public Companies, under Sec. 63 permission to commence business will not be given unless the promoters have paid all the called amount on the shares taken by him are fully paid. Such paid-up capital amount shall not be less than Rs.1 crore for Public Companies under Sec.11 (1).

Meaning of "Promoter"

Someone whose profession it was to form bogus companies and foist them off on the public to the latter's detriment and his own profit. Such persons have existed and it is probably too much to hope that they will ever be entirely eradicated, but even in their Edwardian heyday they formed only the minutest fraction of those whom the law classifies as promoters. A much more typical, if less romantic, example, would be the village grocer who converts his business into a limited company. He, of course, is in no sense a professional company promoter, always and increasingly a rare bird, but he would be the promoter of his little company, and the difference, however great, between him and a professional promoter is basically one of degree rather than of kind.

Both the professional promoter and the village grocer are promoters to the fullest extent, in that each under takes to form a company with reference to a give project, and to set it going and takes the necessary steps to accomplish that purpose. But a person may be a promoter who has taken a much less active and dominating role; the expression may, for example, cover any individual or company that arranges for someone to become a director, places shares, or negotiates preliminary agreements. Nor need he necessarily be associated with the initial formation of the company; one who subsequently helps to arrange the 'floating off' of its capital will equally be regarded as a promoter. On the other hand, those who act in a purely ministerial capacity, such as solicitors and accountants, will not be classified as promoters merely because they undertake their normal professional duties, although they may become one if, for example, they have agreed to become directors or to find others who will. Who constitutes a promoter in any particular case is therefore a question off act.

Duties of Promoter

In a series of cases in the last quarter of the nineteenth century, they laid it down that anyone who can properly be regarded as a promoter stands in a fiduciary position towards the company with all the duties of disclosure and accounting which that implies; in particular he must not make any profit out of the promotion without disclosing it to the company. The first leading case on the subject, *Erlanger v New Sombrero Phosphate Co*, [(1878) 3 App. Cas.1218. HL]

suggested that it was his duty to ensure that the company had an independent board of directors and to make full disclosure to it. The facts of the case were as follows:

A group of persons headed by *E* purchased an island containing phosphate mines for £55,000. A company was then incorporated to take over the island and to work the mines. *E* named five persons as directors. Two were abroad. Of the three others, two were persons entirely under *E*'s control. These three directors purchased the island for the company at a price of £1,10,000. A prospectus was then issued. Many persons took shares. The purchase of the island was adopted by the shareholders at their first meeting; but the real circumstances were not disclosed to them. The company failed and the liquidator sued the promoter for refund of the profit.

The only material contention urged on behalf of the promoter was that the company's board of directors had full knowledge of the facts. Rejecting this Lord CAIRNS said: If they (promoters) propose to sell their property to the company, it is incumbent upon them to take care that they provide the company with an executive body who shall both be aware that the property which they are asked to purchase is the promoter's property and who shall be competent and impartial judges as to whether the purchase ought or ought not to be made. They should sell the property to the company through the medium of a board of directors who can and do exercise an independent and intelligent judgment on the transaction. An entirely independent board would be impossible in such cases.

If the real truth is disclosed to those who are induced by the promoters to join the company, the promoter cannot escape liability by disclosing to a few cronies, who constitute the initial members, when it is the intention to float off the company to the public or to induce some other dupes to purchase the share. This was emphasized by the speeches of the House of Lords in the second great landmark in development of this branch of the law – *gluckstein v Barnes [1900: AC: 240*]

A syndicate of persons was formed to raisea fund, buy aproperty, called'Olympia' andresell it to a company. They first bought up some of the charges upon the property for sums below the amount which the charges afterwards realized, and thereby made a profit of £20,000. They bought the property for £1,40,000, formed a limited company and resold the property for £1,80,000 to the company, of which they were first directors. They issued a prospectus inviting applications for shares and disclosing the two prices of £1,40,000 and £1,80,000 but not the profit of £20,000. Shares were issued but the company after wards went into liquidation.

It was held that the promoters ought to have disclosed to the company the profit of £20,000. The defendant, who was one of the promoters, contended that the fact was known to the parties to the transaction. Rejecting this, HALSBURY LC said: "It is too absurd to suggest that a disclosure to the parties to this transaction is a disclosure to the company. They were there by the terms of the agreement to do the work of the syndicate, that is to say, to cheat the shareholders; and this, forsooth, is to be treated as a disclosure to the company, when they were really there to hoodwink the shareholders, and so, far from protecting them, were to obtain from them the money, the produce of their nefarious plans".

The position therefore seems to be that disclosure must be made to the company either by making it to an entirely independent board or to the existing and potential members as a whole. If the first method is employed the promoter will be under no further liability to the company, although the directors will be liable to the subscribers if the information has not been passed on in the invitation to subscribe; indeed, if the promoter is a party to this invitation, he too will be liable to the subscribers. If the second method is adopted disclosure must be made inthe prospectus, or otherwise, so that those who are or become members, as a result of the transaction in which the promoter was acting as such, have full information regarding it.

Remedies for Breach of Promoter's Duties

Since the promoter owes a duty of disclosure to the *company*, the primary remedy against him in the event of breach is for the company to bring proceedings for rescission of any contract with him or for the recovery of any secret profits which he has made.

If the contract is rescinded the promoter's secret profit will normally disappear as a result, but if he has made a profit on some ancillary transaction there is no doubt that this too may be recovered. Moreover, a secret profit may be recovered although the company elects not to rescind. The classic illustration of this is *Gluckstein v Barnes* itself. In that case a syndicate had been formed for the purpose of buying and reselling Olympia, then owned by a company in liquidation. In the prospectus the profit of £40,000 was disclosed. But in the meantime the promoters had the charges on the property repaid by the liquidator out of the £140,000 and thereby made a further profit of £20,000. This was not disclosed in the prospectus, though reference was there made to a contract, close scrutiny of which might have revealed that some profit had been made. Four years later the new company went into liquidation and it was held that the promoters must account to the company for this secret profit.

Remuneration of Promoters

A promoter is not entitled to recover any remuneration for his services from the company unless there is a valid contract to pay between him and the company. Indeed, without such a contract he is not even entitled to recover his preliminary expenses or the registration fees. In this respect the promoter is at the mercy of the directors of the company. Until the company is formed it cannot enter into a valid contract and the promoter therefore has to expend the money without any guarantee that he will be repaid. In practice, however, recovery of preliminary expenses and registration fees does not normally present any difficulty. Model Articles usually contain an express provision authorizing the directors to pay them and, although this did not constitute a contract between the company and the promoter, it empowered the directors to repay expenses properly incurred. The whole tenor of the Act assumes that preliminary expenses properly incurred will be borne by the company and that the general delegation of the company's power to the board of directors suffices.

As Lord Hatherly said in Touch v. Metropolitan Ry. Warehousing Co. [(18710L.R. 6 Ch.App.671]: "The services of a promoter are very peculiar; great skill, energy and ingenuity, may be employed in constructing a plan and in bringing it out to the best advantage". Hence it is perfectly proper for the promoter to be rewarded, provided, as we have seen, that he fully

discloses to the company the rewards which he obtains. The reward may take many forms. The promoter may purchase an undertaking and promote a company to repurchases it from him at a profit, or the undertaking may be sold directly by the former owner to the new company, the promoter receiving a commission from the vendor. A once popular device was for the company's capital structure to provide for a special class of deferred or founders' shares which would be issued credited as fully paid in consideration of the promoter's services. Such shares would normally provide for the lion's share of the profits available for dividend after the preference and ordinary shares had been paid a dividend of a fixed amount. This had the advantage that the promoter advertised his apparent confidence in the business by retaining a stake in it; but all too often his stake (which probably cost him nothing anyway) was merely window- dressing. And if, in fact, the company proved an outstanding success the promoter might do better than all the other shareholders put together. Today, when the trend is toward simplicity of capital structures, founders' shares are out of favor and, in general those old companies which originally had them have got rid of them on a reconstruction.

Preliminary Contracts by Promoters

Until the company has been incorporated, it cannot contract or enter into any other act in the law. Nor, once incorporated, can it become liable on or entitled under contracts purporting to be made on its behalf prior to incorporation, for ratification is not possible when the ostensible principal did not exist at the time when the contract was originally entered into. Hence, preliminary arrangements will either have to be left to mere "gentlemen's agreements" or the promoters will have to undertake personal liability.

The above matter has been confirmed by Sec. 17(2) of the Companies Act. But Sec. 17(3) provides that the company may adopt such obligations by its contract, transaction or practice within a reasonable time after the incorporation of the company or by accepting the loans incurred prior to the receipt of certificate to commence and such transaction will be binding on the company as well as the third party and the promoter i.e. the person working on behalf of the company will be relieved of his personal liability.

In the case of private companies such transaction will be governed by the provisions in its Article of Association and the unanimous agreement between the members.

9 SHARES

A man's movable property is of two kinds, namely, chose-in possession and chose-in-action. Chose-in-possession means property of which one has actual physical possession, but chose-in-action means property of which one does not have immediate possession, but has a right to it, which can be enforced by a legal action. A share in company is also a chose-in-action and a share certificate is the evidence of it.

Section 2 of the Indian Sale of Goods Act defines goods as including every kind of moveable property. Hence share in a company in India are goods and not mere chose-in-action. The analysis of the 'share' in terms of goods has been carried further to some of its natural implications by the Supreme Court in *LIC Escorts Ltd.* [(1986) 1 SCC 264 at p. 321: (1986) 59 Comp Cas 548]. If

shares are goods, rules relating to passing of ownership in goods would apply. Section 19 of the Sale of Goods Act says that property in the goods passes when it is intended to pass. 'Shares' are specific goods and Section 20 of the Act says that ownership in specific goods passes when the contract is made. Thus a purchaser of shares becomes the owner of the property in the shares when he contracts to buy them. The inevitable implication of these provisions is that the company cannot deprive him of his ownership by refusing to register him as a shareholder unless there is a genuine reason to do so. But even so shares are not 'goods' in the ordinary sense of the word.

Shares are a peculiar kind of movable property which cannot pass from hand to hand like bales of cotton. The property in these shares belonged to the registered shareholders and could not be transferred to another except according to the articles of association of the company.

The exact nature of a share does not admit of easy explanation. A person who holds such a share is known as the shareholder. Each shareholder, therefore, holds a portion of the capital of the company. 'A share means a share in the capital of the company. It is a tangible property'. 'Shareholders are not, in the eyes of law, part owners of the undertaking. The undertaking is something different from the totality of the shareholdings'. All the assets of the company are vested in the corporate body and not in the individuals composing it. Hence a share does not constitute the holder a part owner of the company's properties.

A share is not a sum of money but an interest measured by a sum of money and made up of various rights and liabilities. A share is an existing bundle of rights. Share certificates are not valuable property in themselves they are just evidence of the true property, which are the proportionate interests of the shareholders in the ownership of the company. One *pari passu* share is exactly the same as any other. This was recognized in *Solloway v McLaughlin* [(1937) 4 All ER 328: (1938) AC 247]. Therefore, each share certificate with the depository evidences the same bundle of rights and each bundle of rights can satisfy the client's proprietary interest as any other [*Pacific Finance Ltd, Re,* (2000) 1 BCLC 494]. A share, for example, entitles the holder to receive a proportionate part of the profits of the company; to take part in the management of the company's business in accordance with the articles, to receive a proportion of the assets in the event of the winding up and all other benefits of membership. A share also carries some liabilities, for example, the liability to pay the full value in winding up. All these rights and liabilities are subject to the terms and conditions contained in the company's article. Rights and liabilities as regulated by articles are of the very essence of a share.

What is bought and sold in the market is not productive wealth itself, but income producing prospects. Right to income has become commodity for exchange. In other words, the shareholder has a piece of property with an open market value.

Issue of Shares at Discount

Generally, speaking, the Companies Act, 2063 has always discouraged issue of shares for a price less than their face value [Sec. 64(1)].

Law does not tolerate issue of shares at a discount even in an indirect way. In the first place, the shares of the class issued for the first time are not allowed to be sold at a discount. Issue of shares at a discount can be allowed only in the following circumstances:

(i) Shares are issued in accordance with a scheme of capital restructuring of the company,
(ii) Shares are issued with the consent of the creditors for converting the loans taken by the company into shares,
(iii) Shares issued in accordance with the employee share scheme
(iv) Shares issued under other circumstances approved by OCR.

A special resolution authorizing the issue shall be passed at a general meeting. The resolution shall specify the rate of discount. In England and India only the class of shares already once issued for full value can be issued at a discount. But no such explicit provision is made in the Nepal Act. In India, such share should be issued within two months from the date of sanction by the Company Law Board. But there is no time limit mentioned in sec.64.

Sweat Equity Shares

The Indian Companies (Amendment) Act, 1999 introduced this section (w.e.f.31-10-98) enabling [Sec. 64(4) (c) liable] companies to issue shares in lieu of services. The shares should be of a class which has already been once issued. The issue should be authorized by a special resolution at a general meeting of the company. The resolution should specify the number of shares and their current market price and also the class or classes of directors or employees to whom they are to be issued and consideration for the sweat equity shares proposed to be issued. Sec. 64(2) of the Companies Act, 2063 recognizes issue of shares at a discount under employee share participation scheme.

'Sweat equity shares' means equity shares issued at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by what so ever name called.

Shares issued as sweat equity shares are to be treated for all purposes like other shares and, therefore, all the limitations, restrictions and provisions relating to equity shares will be applicable to them.

Issue of Shares at Premium (Sec.29)

If the market exists, a company may issue its shares or securities at a price higher than their nominal value. There is no restriction whatever on the sale of shares at a premium. But Guidelines have to be observed as they indicate when an issue is to be at par and when premium is chargeable.

Sec.29 of Companies Act, 2063 provides preconditions for issue of shares at a premium by any company. They are:

Any public company that can issue shares publicly pursuant to prevailing laws on securities may by fulfilling the terms and conditions as specified in the prevailing laws on securities issue shares at a premium. But a private company or a public company which has not made provision

to issue shares publicly pursuant to prevailing laws on securities may issue shares at a premium if its assets exceed its liabilities and by obtaining approval of the general meeting.

> Prior permission of the OCR shall be obtained for issue of shares at a premium. While applying for prior permission, previous three years audited account copies also shall be submitted.

Premium may be received in cash or in kind, where the value of the assets received by a company as a consideration for allotment is greater than the nominal value of shares. It is in essence an allotment at a premium. An amount equal to the extra value of assets would have to be carried to the share premium account. The Act does regulate the disbursement of the amount collected as premium. It is clearly provided that the amount so received more than its face value, whether in cash or kind, shall be carried to a separate account to be known as *the Securities Premium Account*. The amount to the credit of share premium account has to be maintained with the same sanctity as share capital and can be used in the following four ways:

(a) It may be applied to issue to the shareholders as fully paid by way of bonus shares out of un-issued shares of the company;
(b) It may be used to write off preliminary expenses incurred by the company;
(c) It may be used to write off commission or discount paid or incurred in connection with issue of shares;
(d) It may be spent in providing for the premium payable on the redemption of preference shares of the company.

A reduction of the share premium account was allowed under a scheme which experts had approved as fair, just and proper. Reduction of the share premium account for wiping out losses incurred in trading in securities was allowed. The articles of association enabled the company to reduce its share premium account. The reduction of capital did not involve either diminution of liability in respect of unpaid capital or payment to any shareholder of paid up capital. Creditors and shareholders raised no objections. [*Hyderabad Industries Ltd. Re,* (2004) 53 SCL, 396 Bom]

Issue of Shares with Different Rights (Sec. 30)

A provision may be made in the Memorandum and Articles of Association for issuing shares with different rights attached thereto. Any variation intended to be made to the rights of any particular class of shares will require approval of the shareholders of that class. But such alteration should not be to the detriment of any other class of shareholders, unless the latter agree to such variation affecting their rights.

The Board of Directors shall present the proposal as a special resolution to be passed at the general meeting of the shareholders of the particular class and should be passed as a special resolution by that meeting with three fourth majority of the shareholders present at the general meeting.

If any shareholders holding at least ten percent of the total share units of any particular class are not satisfied with such decision to vary the rights, he can file a petition to the court against the

decision to alter the rights and until the decision of the court is received no such alteration will have any effect.

The petition to the court as above shall be made within thirty days of the date the decision was made. Therefore, the decision at the meeting of the shareholders shall not be effective until the expiry of 30 days from the date of the decision. If the alteration is found to be prejudicial to the interest of the petitioner shareholders, the court may set aside the decision.

In the course of privatization of any company owned fully or partly by the Governmentof Nepal as per the prevailing laws, there will be special voting rights of the Government of Nepal in such companies, so long as the investment of the Government of Nepal continues, to decide on the following matters as provided in the articles of association of such company:

(a) On a resolution to relinquish the title to an undertaking pursuant tosec.105(1)(a) i.e. to sell away the assets of the company,
(b) On a resolution to voluntarily wind up the company,
(c) On a resolution to amalgamate the company with any other company.

Even though the Government of Nepal may be a minority shareholder in the privatized company, still it can have a golden vote of vetoing there solution.

Now there are only two classes of shares viz. Equity or ordinary shares and Preference shares with preference as to dividend and/orcapital. Even within the same class, the resolution should not be prejudicial to the interest of the minority shareholders.

Allotment of Shares

Offers for shares are made on application forms supplied by the company. When an application is accepted, it is an allotment. "What is termed 'allotment' is generally neither more nor less than the acceptance by the company of the offer to take shares". Broadly speaking it is an appropriation of share by the directors to a particular applicant. It is an appropriation out of the previously unappropriated capital of a company. Consequently where forfeited shares are re-issued, it is not the same thing as an allotment. Following are the statutory restrictions on allotment of shares

(a) Minimum Subscription and Application Money

The first requisite of a valid allotment is that of minimum subscription. When shares are offered to the public, the amount of minimum subscription has to be stated in the prospectus. Minimum subscription means the amount which is, in the estimate of the directors, enough to meet the following needs, namely, purchase price of any property to be defrayed partly or wholly out of the proceeds of the issue, preliminary expenses and working capital (not to be less than 90% of the whole issue offered to the public, as now prescribed under the Indian companies Act). No shares can, be allotted unless at least so much amount has been subscribed and the application money, which must not be less than five per cent of the nominal value of the share, has been received in cash. Under the Nepal Companies Act, minimum subscription should be at least 50% of the whole issue offered to the public or 50% issue must have been underwritten and should be

allotted within a maximum three months from the close of subscription. The application money shall not be more than 50% of the face value of share in the case of first issue of freshly established public company.

A number of cases have established that it is a condition precedent for valid allotment that the whole of the application money should have been paid to and received by the company in cash. Further, it has been held that an allotment of shares made without the application money being paid is invalid and the directors are guilty of misfeasance.

If the allotment could not be made within 3 months owing to non-receipt of minimum subscription, then within 7 days from the expiry of the date, the company may apply to OCR for extension of time and a further time up to 3 months may be granted by OCR. If the share could not be allotted, then the shares can be allotted by negotiation or any other process.

If the minimum subscription has not been received within the time allowed for allotment, under sec. 28(3) them one received from the applicants must bere paid with interest from the closing date of subscription till the date of return of the money. If the money is not paid back, the promoters and directors become personally liable for it with interest under sec.28(4), if the amount remaining with company is not sufficient to be refunded, unless they can show that the default was not due to any negligence or misconduct on their part. Application money can be appropriated towards allotment or it has to be refunded. It cannot be adjusted towards any claim of the company against the applicant. The rate of interest is not however provided in the Act.

(b) Opening of Subscription list

Shares cannot be simply allotted at once after the issue of the prospectus. Instead, section 28 enjoins that allotment shall be made within maximum 3 months from the close of subscription. This is known as the time of opening of subscription list. The directors may extend this time by a statement to that effect in the prospectus, but it cannot be cut short. The validity of an allotment is not affected by any contravention of this section, although a penalty is imposed on the company and its officers. Under the Indian companies Act, no allotment could be made till 5^{th} day of opening of subscription. In other words, the subscription should kept open at least for five days. The same rule is laid down by the Securities Board of Nepal also.

(c) Shares to be dealt in on Stock Exchange

Every public company intending to offer shares or debentures to the public by the issue of a prospectus has to make an application to the Securities Board of Nepal and then enlist such allotted securities to any one or more of the recognized stock exchanges for permission for the shares or debentures to be dealt with at the exchange.

General principles of Allotment of Shares

An effective allotment has to comply with the requirements of the law of contract relating to acceptance of an offer.

(a) Allotment by proper authority

In the first place, an allotment must be made by a resolution of the board of directors.'Allotment is a duty primarily falling upon the directors', and this duty cannot be delegated except in accordance with the provisions of the Articles. Accordingly, an allotment made by a general manager under an improper delegation by the directors was held to be void.

(b) Must be communicated

The allotment must be communicated to the applicant. Posting of a properly addressed and stamped letter of allotment is a sufficient communication even if the letter is delayed or lost in the course of post. *Household Fire and Carriage Accident Insurance Co v Grant* is the leading authority.

The defendant Grant applied for some shares in the plaintiff company. His application was sent by post and a letter of allotment was dispatched by the company soon after. But the letter never reached the applicant. He was nevertheless held liable as a shareholder.

(c) Absolute and unconditional

Allotment must be absolute and in accordance with the terms and conditions of the application, if any. Thus, where a person applied for 400 shares on the condition that he would be appointed cashier of a new branch of the company, the Bombay High Court held that he was not bound by any allotment unless he was so appointed. A condition which is to operate subsequently to allotment will not affect its validity. An applicant to whom shares were allotted on the condition that he would pay for them only when the company paid dividends was held to be bound even though the company had gone into liquidation before paying any dividend.

The applicant must promptly reject the allotment when shares have been allotted to him without his condition being fulfilled. Acquiescence on his part would amount to a waiver of the condition. Thus where a shareholder accepted or pledged his shares, he was held to have lost his right to insist on the condition in his application.

(d) Allotment on an equitable basis

Under sec.28 (5), the allotment should be made on an equitable basis without any favoritism shown to any applicant and without causing loss to any investor discriminatorily. If any allotment is made in such a way, any applicant may file a complaint in the court giving reasons for such allotment. If such allotment has been made knowingly at the instance of any officer or director and if it is proved that any loss has been caused to any investor, then the court may order such officer to be personally liable to compensate the loss as well as pay the cost of the pursuing the case in the court.

Return as to Allotment

Under sec.31 of the Act, within thirty days of allotment of shares, a company is required to send to the Office of Company Registrar a report, known as the 'return as to allotment'. It must contain the following particulars:

(a) The number and nominal amount of shares allotted; the names, addresses and occupations of the allottees; the amount, if any, paid or payable on each share. No shares shall be shown as allotted for cash unless cash has actually been received in respect of the allotment.
(b) Contract is writing under which shares have been allotted for any consideration other than cash, must be produced for examination of the Registrar.
(c) Where bonus shares have been issued, the return must show the nominal amount of the shares allotted; names and addresses and occupations of the allottees and a copy of the resolution authorizing the issue of such shares.
(d) Where the shares have been issued at a discount, the return must include a copy of the resolution authorizing such an issue.

Certificate of Shares

Sec. 33 of the Companies Act provides that an allottee of shares is entitled to have from the company a document, called share certificate, certifying that he is the holder of the specified number of shares in the company. Accordingly, every company making an allotment of shares or debentures or debenture-stock is obliged to deliver to the allottee a certificate of shares, etc. within two months after the allotment. In the case of transfer, the certificate has to be delivered within a reasonable time. But if the directors refuse to accept the transfer, then within 15 days, both the transferor and transferee shall be informed Sec. 44 of the Companies Act.

Transfer of Shares

"When joint stock companies were established, the great object was that the shares should be capable of being easily transferred. Accordingly, by Section 42(1) of the Companies Act, it is provided that the shares or debentures or other interest of a member in a company shall be moveable property capable of being transferred in the manner provided by the articles of the company. "The regulations of the company may impose fetters upon the right to transfer. But in the absence of restrictions in the articles the shareholder has by virtue of the statute the right to transfer his shares without the consent of anybody to any transferee, even though he be a man of straw, provided it is a *bona fide* transaction in the sense that it is an out and out disposal of the property without retaining any interest in the shares". A transfer made with the avowed object of escaping liability was held to be valid in *Discoverers Finance Corpn Ltd. Re [(1910) 1: Ch 207]:*A holder of partly paid shares, being alarmed at the precarious condition of the company and with a view to escape liability on the shares, sold his shares, to a purchaser in Germany for nominal price, which he never received. The transfers were duly lodged and passed by the Board of Directors. It was held that, in the absence of any collusion between him and the directors, the transfers were effective. The transferee is the proper person to apply for registration of transfer, but the transfer or may also apply. "The transfer or is entitled as much as the transferee to enforce registration".

The following conditions shall be fulfilled before a company can lawfully register a transfer:

(a) The instrument of transfer must be executed both by the transferor and the transferee. The instrument must specify the name, address and occupation, if any, of the transferee. It should also comply with the requirements of the company'sarticles.

(b) The instrument should be delivered to the company along with the certificate relating to the shares transferred.
(c) Presentment to the company should be made, in the case of shares quoted on the recognized stock exchange, before the company closes the register of shareholders in accordance with the provisions of the Act.
(d) An instrument of transfer which does not fulfill this requirement shall not be accepted.
(e) The transfer should be approved at a valid meeting of the company's Board of directors.

Blank Transfers

A blank transfer form means a form which has been signed by the transferor only and there is no other entry on it. It is given over to the transferee with the right to have himself or any other person registered as a shareholder. A blank form could remain in circulation for any length of time creating many problems mostly that of evasion of taxes and priority between transferees.

A blank transfer form is a valid instrument. The basic principles were restated by the Gujarat High Court in *Pranlal Jayanand Thakur v V. R. Shelat*. Firstly, an instrument of transfer which carries no entry except the signature of the transferor is a valid instrument. Secondly, a person to whom such an instrument is delivered along with share scripts gets an implied authority to complete the instrument. Thirdly, the transferee acquires good title to the shares if he has received the documents in good faith and for consideration.

The facts of the case were that the transferee had received the shares under a gift deed from a lady who signed blank transfer forms which, however, could not be registered before her death.

The other heirs having claimed the shares, the court held that the transferee had not acquired a good title to shares as he had received them without consideration. The gift was not complete without registration. But on appeal to the Supreme Court this decision was reversed [Vasudev Ramachandra Shelta v Pranlal Jayanand Thakur, (1974) 2 SCC 323: AIR 1974 SC 1728: (1975) 1 SCR 534: (1975) 45 Comp Cas 43]. In the view of the Supreme Court a complete gift had taken place on delivery of the share scripts and transfer deeds. Registration with the company was formality which had nothing to do with the completeness of the gift as between the parties.

Restrictions on Transfer (Private Companies)

It is open to a company to restrict the right of its shareholders to transfer their shares. The articles of a private company as against those of a public company contain more rigorous restrictions on the right of its shareholders to transfer shares.This is so because private companies are (no doubt) in law separate entities just as much as are public companies, but from the business and personal point of view they are much more analogous to partnerships than to public corporations. Accordingly, it is to be expected that in the articles of such a company the control of the directors over the shareholders may be very strict indeed. Moreover, the Act itself requires a private company to impose some restrictions on the right of transfer. Articles requiring that on the insolvency of a member his shares would be transferred at a fair value to a nominee of the directors or that on the death of a member his shares must be offered to the other shareholders have been held to be valid. Articles providing that shares can be transferred to

outsiders only if no existing shareholders accept them at face value are called pre-*emption* clauses. Such a clause does not authorize the directors to refuse to register a transfer so long as it is made to an existing member only. Where no existing member accepts the proposal, transfer in favor of an outsider should be allowed. Articles may contain a clause that the other shareholders will be bound to take shares so offered. The question is in what manner the directors shall exercise this power and to what extent the court can interfere in its exercise. Some of the principles were laid down in *Smith and Fawcett Ltd*, Re. [(1942)Ch:304]: A clause in the articles of a private company provided: "The directors may at anytime in their absolute and uncontrolled discretion refuse to register any transfer of shares". The issued capital of the company consisted of 8002 share of which the two directors of the company S and F held 4001 each. F died and his so applied to have the shares registered in his name. But S, in the exercise of the above power refused to consent to the registration. He, however, offered to accept the applicant up to 2001 shares, provided the remaining was sold to him at a fixed price. The plaintiff brought an action contending that S's refusal to register the transfer was on a wrong principle since it was not made for the benefit of the company but was rather to preserve his own dominating position. It was held that the court would not be justified in interfering in the discretion of the directors. "The directors must exercise their discretion bonafide in what they consider not what a court may consider is in the interest of the company". And if they have done that, the court cannot substitute its judgment for theirs.

Transfers Contravening Pre-emptive Clauses

A company can reject a transfer contravening the provisions of the company's articles, but the company can waive its right and accept a contravening transfer and once it does so, it loses the right to question the validity of the transfer. Hence, a transfer contravening articles is not a nullity, nor *void ab-initio*. A transfer in violation of pre-emptive provision can be set right by subsequent assent of shareholders or by ratification or even by acquiescence. What has been described as 'the most explicit authority' is T*ett v Phoenix Property and Investment Co Ltd* [1984 :BCLC 599]where VINELOTT J 'held that despite the disregard to the pre-emptive provisions there had occurred a complete and effective transfer between transferor and transferee in terms of which the equitable title passed to the latter'. In this case, the shares in question were sold to an outsider and a transfer deed executed in his favor completely forgetting the pre-emotive clauses. Some shareholders were interested in acquiring the shares but not at a price which *Tett* was prepared to pay. Even so the Court of Appeal held that the company was not compellable to accept the transfer. The decision has been appreciated. The privacy of a 'close corporation' is more important than the price offered by an outsider.

Where the articles required a member desiring to transfer his shares to inform the company specifying his price and he specified a price which was likely to vary according to certain future events, it was held that the notice had to specify a certain price and the same having not been done, the notice was defective.

The articles of association of a private company prohibited transfer to non-shareholders. The shares of a shareholder were sold under a court auction. It was held that even such a sale could not knock off the prohibition. The Board of directors was entitled not to accept the transfer.

Private Agreement Between Shareholders

A private agreement between two or more shareholders, which is not incorporated in the company's articles, restricting the right of transfer, does not bind the company. The company can be compelled to register a transfer even if it violates such an agreement.

Listed Public Companies and Pre-emptive Clause

Refusal by a listed public company to register a transfer of shares on the ground of pre-emptive rights of existing shareholders was held to be not justified. Where share of such companies are subject to pre-emptive clauses, they have to carry a warning on the face of the certificate. There being no such warning in the present case, the company had no right to refuse. *Pawan Gupta v Hicks Thermometers Ltd, [(1999) 98 Comp Cas 814 CLB.]*

Power to Refuse registration and Appeal Against Refusal

In Harinagar Sugar Mills Ltd v Shyam Sunder Jhunjhunwala [AIR 1961: SC: 1669]:A company having refused to register a transfer, an appeal was preferred before the Central Government. The latter ordered the company to register the transfer but gave no reasons. The company appealed against the Government's order.

It was held that the power of the Central Government was of a judicial nature and must be exercised subject to the limitations of a judicial tribunal. The Central Government has to decide whether in exercising their power the directors are acting oppressively, capriciously, or corruptly, or in some way *mala fide.* The decision has manifestly to stand those objective tests, and has not merely to be founded on the subjective satisfaction of the authority deciding the questions. The power of directors to refuse to accept a transfer is exercisable whether the transfer is by one member to another or from a member to an outsider.

Time for Exercising Power of Refusal

The period prescribed by the section for refusing an application for transfer is that of 15 days. This arises the question whether on the expiry of 15 days the company loses the right of rejection and the transferee gets a vested right to get himself registered. The section does not speak anything on the point and, it if speaks at all, it only talks of penalty for the default. The Bombay High Court, facing this problem, as it seems to be, for the first time, did not agree with the view either that the company would lose the right of rejection or that the transferee would acquire vested right. But the position as established through cases is that the disposal must be within reasonable time. The intention of legislature seems to be to confer only a time-bound right of rejection. It is a characteristic of such privileges that they lapse with the expiry of time. The legislature means to say that the transfer shall be registered, if not rejected within fifteen days.

Compensation for Delay

A transfer had remained pending for 20 years. During this period the company remained in the hands of rival groups and had also become a public company. For certain periods in between the transferee herself was a part of the management and partly responsible for the delay. She could not get the relief of an order for registering shares in her name and rectifying the register of

shareholders accordingly. She was held entitled to compensation for her loss. *Claude-Lila Parulekar v Sakal Papers (P) Ltd,* (2005) 124 Comp Cas 685SC.

Rectification of Register

If a person's name appears in the shareholder register, he is presumed to be the shareholder, even if, in fact, he is not so unless otherwise proved. Contrarily, if a person's name is absent from the register, apparently he is not a shareholder, although he may have done everything to entitle him to become one. Injustice may, therefore, result if a company's register of shareholder is not maintained according to law. It is, therefore, the duty of the company to keep the register up to date so as to give at all times the accurate and correct position as to particulars of shareholding. If the company does not do so, an order can be sought from OCR in respect of all matters. The power to order rectification of the register has, therefore, been conferred on the OCR. An aggrieved person or any shareholder or the company itself may apply for rectification on any of the following grounds:

(a) Where a person's name has been entered in the register without sufficient cause. Thus rectification has been ordered on this ground where a person was induced to become a member by misleading prospectus, where allotment was invalid, or where a forged transfer has been registered, or where the allotment was subject to shareholders 'approval and they did not do so, or where a transfer could be effected only with the approval of the Board of directors and there was no evidence of any such approval.
(b) Where a person's name being in the register has been without sufficient cause deleted.
(c) Where a person has fulfilled every requirement of law to enable him to become a member, but the company has defaulted or delayed or caused unnecessary delay in placing his name in the register [including refusal to register a transfer within the meaning of sub-section (1) and where a person has rightly ceased to be a member but his name has not been removed with due promptitude from the register.

Where discovery and inspection are necessary and complicated questions such as forgery and fabricated documents arise, the summary procedure trial should not be allowed.

Similarly, Delhi High Court – [*Punjab Distilling Industries v B.P.C. Mills Ltd.* (1973) 40 Comp. Cas 189 Del] rejected a petition under the section as it involved ascertainment of a number of facts like the value of imported machinery against which shares were allotted and which required expert opinion and its cross-examination and the Madhya Pradesh High Court did not entertain a petition which required investigation as to whether there was a free consent or one under undue influence or fraud. [*Kamala Devi Mantri v Grasim Industries Ltd,* (1990) 69 Comp Cas 188 MP: [1989] 3 Comp LJ 278. A dispute between joint purchasers of shares. A Full Bench of the Kerala High Court ordered the company to register the respective names in the agreed proportion. The Supreme Court rejected appeal against it. It was a matter of civil court jurisdiction and not of the company court. K. P. Antony v Thandiyode Plantations (P) Ltd, (1996) 86 Comp Cas 684 Ker (FB). Doubts about the validity of a will cannot be considered under this jurisdiction. T. G. Veera Prasad v Shree Rayalseema Alkalies & Allied Chemicals Ltd, (1997) 89 Comp Cas 13 CLB: G.N. Bayra Reddy v Arathi Cine Enterprises (P) Ltd., (1997) 89 Comp Cas 745 CLB. This jurisdiction would include an inquiry into the validity of an allotment of securities, Shiv Dayal Agarwal v Siddhartha Polyester (P) Ltd, (1996) 88 Comp Cas 705 CLB].

But apart from the case where complicated questions arise, the Supreme Court of India has laid down that 'the jurisdiction created by the section is very beneficial and should be liberally exercised'. The question whether an allotment of shares is in accordance with the articles of the company has been held by the Patna High Court to be not such a complicated question as cannot be disposed of in a petition for rectification. The court accordingly ordered deletion of names of certain persons to whom shares were allotted in violation of articles. The Gujarat High Court expressed the opinion that a petition under the section is more or less analogous to a suit and, therefore, the court can decide all questions which can be tackled in a regular suit. Where the claimant was not able to produce even a transfer form, the court allowed him to prove his title to the shares, because if he could do so, the execution of the transfer form could be ordered.

In the case of refusal to transfer shares, in India a procedure for applying to Company Law Board was prescribed, which could look into the procedures adopted under the Companies Act either approve or disapprove the refusal. But under the Nepal Companies Act, against improper refusal, the aggrieved party shall have to approach the Court only for relief.

Director's Power of Rectification of Entries

It is open to directors to rectify the register of shareholders of their own even where there are no objections and a wrong entry has been detected. There is no need, in such a case, to apply to the Court for an order of rectification. If there is no dispute, and if the circumstances are such that the tribunal would order rectification, the Board may itself effect the necessary corrections. An application to the court is only essential when the company disputes the right to rectification. There is no reason why the directors if they *bona fide* agree and that a shareholder has the right to avoid a contract should not thereupon assent to the rescission of the contract and rectify the register in the appropriate manner. An order of the court is not necessary in such cases.

However, the directors have no power to rectify the register by substituting the name of another person in the place of an existing, except on an application for transfer duly made in compliance with the provisions of Section 108-Indian Companies Act.

Procedure of Transfer

A transfer of shares is completed by registration with the company, or in other words, a transfer is incomplete until registered and the transferor remains legal owner of the shares liable for the unpaid amount, if any. Thus where, without any fault or unnecessary delay on the part of the company, duly lodged transfers could not be registered before the commencement of winding up, the transferor could not have his name removed from the list of contributories. But where a transfer was omitted to be entered by mistake or oversight, rectification was ordered not with standing winding up. [Sussex Brick Co. Re, (1904) 1 Ch 598: (1904-07) All ER Rep 673:90 LT 426]

Transfer Contravening Section 108 Under the Indian Companies Act

When requirements of Section 108 are complied with, the company must register the transfer. The name of the transferor is struck off the register of members and that of the transferee substituted.

Where the trustee of the shares passed a resolution authorizing one of them to transfer the shares, it was held that the transfer under such authority was not valid. The trustees could not delegate the power to one of them. The transferee could not apply for rectification of the register of members. [*Claude – Lila Parulekar v Sakal Papers (P) Ltd.* (2005) 124 Comp. Cas 685SC].

Once the necessary formalities have been complied with, the transferee gets the right to be put on the register. Emphasizing this fact in *LIC v Escorts Ltd,* [1986 – 1 SCC 264] *CHINNAPPA REDDY J* of the Supreme Court observed: Where the transfer is regulated by a statute, as in the case of a transfer to a non-resident which is regulated by the Foreign Exchange Regulation Act, the permission prescribed by the statute must be obtained. In the absence of the permission, the transfer will not clothe the transferee with the right 'to get on the register'. Where the permission has been obtained, the transferee may ask the company to register the transfer and the company may not refuse except for a bona fide reason, [but] neither arbitrarily nor any collateral purpose. The paramount consideration is the interest of the company and the general interest of [its] shareholders. Once the permission is obtained it is not open to the company to take upon itself the task of deciding whether the permission was rightly granted.

Certification of Transfer

Ordinarily, the transfer or hands over the certificate of shares to the transferee who then lodges it with the company for registration of such transfer. But where the shares transferred are less than the number of shares included in one certificate, or where they are transferred to different persons, the transferor has to lodge the share certificate with the company. The company then gives him a certificate saying that the shares under transfer have been lodged with the company. This is called 'certification of transfer'. In effect, it is a representation to any person acting on the faith of the certification that the company has received such documents as go to show a *prima facie* title of the transferor, but not that the transferor has any title to the shares. [S. 112(1) Indian companies Act] Thus in Bishop v Balkis Consolidated Co. [(1890) 25 QBD 512 CA].

B transferred his shares to two persons and lodged the certificate with the company. The company certificated the transfer, but, instead of destroying the original certificate, returned it to the transferor who borrowed money on it.

The company was held not liable to the lender. Even if he had deceived a person to accept the transfer of those shares, the company would not have been still liable to the transferee. The reason is that the share certificate is neither a negotiable instrument nor a warranty of title on the part of the company issuing it.

But, if a company issues a false certification negligently or deliberately, it would be liable to any person who is deceived by having acted on the faith of the certification. A certification is deemed to be made by the company when it is signed by a person authorized to do so.

Forgery in Transfer

Sometimes, a forged instrument of transfer may be presented for registration. As one precaution, to write to the address mentioned at shareholder register of the shareholder, and inform him that

such a transfer has been lodged, and that if no objection is made before a day specified, it would be registered. But, not with standing this precaution, a forged transfer may chance to slip through and the consequences will be:

Firstly, a forged transfer is a nullity and, therefore, the original owner of the shares continues to be the shareholder and the company is bound to restore his name to the register of shareholders.

Secondly, if the company has issued a share certificate to the transferee and he has sold the shares to an innocent purchaser, the company is liable to compensate such a purchaser if it refuses to register him as a shareholder.

Thirdly, if the company has been put to loss by reason of the forged transfer, it may recover indemnity from the person who lodged it.

Relationship between Transferor and Transferee

A shareholder who has contracted to sell his shares becomes a constructive trustee of the transferee for those shares until the transfer is duly registered. It is, therefore, the duty of the transferor not to sell the shares again; nor should he prevent or do anything to prevent the company from accepting the purchaser or his nominee. The purchaser also has the right to control the exercise by the vendor of the right to vote and he may so control it as to ask the vendor to vote for the alteration of the company‘s articles so as to procure transfer of shares in his name.

But then how far is the transferor bound to obey the wishes of the transferee? The limits have been explained by the Supreme Court in R Mathalone v Bombay Life Assurance Co. [AIR (1953) SC 385: 24 Comp. Cas1].

A shareholder disposed of a part of his holding, but the company refused to register the transferee as a shareholder. Meanwhile the company increased capital by issuing further shares to the existing shareholders. A number of shares were offered to the transferor, but he applied to take only those few which appertained to his unsold shares. The transferee sought to compel him to apply in his name for the whole of the shares and that for the benefit of the transferee.

But the argument did not find favor with MAHAJAN J of the Supreme Court. But he laid down that as long as a transfer is not registered, the transferor is the trustee of the transferee for the shares, a trustee for the dividends and the right to vote. But he cannot be called upon to incur additional liability. He is not bound to obtain for the benefit of the transferee new shares in the further issue of capital. Nor is the principle of equitable trust extended to cases where the transferee has not taken active steps to get his name registered with due diligence’. But his Lordship added that if the transferor of his own volition chose to obtain the new shares, issued as right shares, which appertain to the shares sold by him, he would have to hand over those shares to the transferee on payment of the amount spent.

If the shares are partly paid and the company calls upon the transferor to pay the unpaid balance, the transferee must provide the money or indemnify the transferor against the amount of the call. [*Spencer v Ashworth, Partington & Co.* (1925) 1 KB 589: (1925) All ER Rep 324 CA]

Bonus shares issued after the transfer were held to be the property of the transferee and not that of the transferor. Where the transfer documents were lost in post and the transfer became delayed because the company did not receive the original documents and in the meantime bonus shares were issued, the transferee was not allowed to sue th ecompany in respect of those shares. His remedy was to proceed against the transferor to whom they were allotted because his name was still there in the register. [Pyariben M. Shah v NIIT Ltd, (2002) 111 Comp Cas 816 CLB]

Mortgage or Pledge of Shares

A share in a company is moveable property. It can, therefore, be delivered as a security for raising a loan. Where a share certificate is delivered to the pledgee it will operate as a pledge. The pledgee can only retain possession till his dues are paid. Where not merely possession of share certificates is delivered, but some right or interest is created in favor of the lender, such as, for example, handing over blank transfer forms under the signature of the transferor, it operates as a mortgage. The mortgagee gets a special interest, for he can have himself registered as a shareholder and the same will be effective against the transferor and his representatives. Where the pledging shareholder executed an agreement in favor of the bank authorizing it to exercise voting rights and the company was also a party to it, the court said that the bank became entitled to exercise voting rights at a meeting on filing the transfer documents. The entry in the register of shareholders was a mere formality. The validity of the pledge, etc., could not be adjudicated by the chairman under the in-house procedure. Where the lender gets himself registered as a shareholder, it would be a clear cut complete transfer. No residuary interest in the pledged shares would survive in favor of the borrower. His interest is protected by his right of redemption, i.e. his right to recover back the shares on paying back the lender. In a case of this kind before the Patna High Court. [*Arjun Prasad v Central Bank of India, AIR 1956Pat.32*]: Certain share certificates were delivered to a bank as against a loan. The blank transfer forms in respect of those shares were signed by all the persons whose signatures were necessary and were delivered to the bank. The company subsequently went into winding up and the bank had the scripts registered in its name, which was done by the liquidator with the permission of the court.

It was held that the registration in favor of the bank was valid. DAS J stated the effect of authorities in these words.

Thus, where under the articles of the company a transfer of shares may be made by an instrument in writing, the shareholder may sign a blank transfer and hand it over to a purchaser or mortgagee with authority to the holder of it for the time being to fill in the name of the transferee, and such a transfer when filled in can be sent in for registration and no objection can be raised by the company to its validity.

Where the original transferee of blank forms further delivers them in blank to another person, the latter will get the rights of the transferor but no better rights. The transfer being in blank, he cannot say that he had received it in good faith.

A simple delivery of share certificates unaccompanied by any transfer forms operates only as a simple mortgage, what is called in English law as an equitable mortgage.

10 SHAREHOLDERS AND MEMBERS

Companies can be: (i) company distributing profit viz. private company and public company or (ii) company not distributing profit. The private and public company issues shares to investors but company not distributing profit does not issue shares. Hence, the investors who subscribe such shares of private and public companies are called shareholders. However, the persons who obtain membership of the company not distributing profit are called members

Definition of Member (Sec. 41 Indian Companies Act)

Section 2(27) talks of a member relation to a company and says that the expression does not include a bearer of a share warrant of the company issued in pursuance of Section 114. This is an exclusion clause rather than a definition. The real definition is to be found in the provision of Section 41 and here the emphasis in both the sub-sections is entry in the register of members. Here is what the section says:

(i) The subscribers of the memorandum of a company shall be deemed to have agreed to become members of the company, and on its registration, shall be entered as members in its register of members.
(ii) Every other person who agrees in writing to become a member of a company and whose name is entered in its register of members shall be a member of the company.
(iii) Every person holding equity share capital of a company and whose name is entered in as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.

How to Become a Member

One may become a shareholder in a company in any one of the following ways:

(a) By subscribing to memorandum [Sec.41]

In the first place, Section 41 of the Act provides that the subscribers of the memorandum of association shall be deemed to have agreed to become the members of the company, and on its registration shall be entered as members in the register of members. Accordingly, it was held in *Official Liquidator v SulemanBhai [AIR: 1955 MB 166]* that: The subscriber of the memorandum is to be treated as having become a member by the very fact of subscription. Neither application form, nor allotment of, shares is necessary. Even an absence of entry in the register of members cannot deprive him of his status. He acquires, as soon as the company is registered, the full status of a member with all the rights and liabilities. The facts were that one S had subscribed to the memorandum of a company for 200 shares. The company was duly registered, but he ultimately took only 20 shares. He was held liable in the winding up of the company to pay for all the 200 shares although they were, in fact, never allotted to him.

(b) By allotment

A person may become a shareholder by agreeing to take shares in the company allotment.

(c) By transfer

One may purchase shares of a company in the open market and then apply to the company to register him as a member. Section 41 which defines 'member' says that it includes the subscribers to the memorandum of a company and every other person who agrees in writing to become a member of the company and whose name is entered in its register of members. Thus it requires two things:

(i) An agreement in writing to become a member and
(ii) An entry in the register.

(c) By transmission

On the death of a member his executor or the person who is entitled under the law to succeed to his estate gets the right to have the shares transmitted to his name in the company's register of members. Transmission is different from transfer. Section 108 which lays down the formalities of transfer specially provides that nothing in the section shall prejudice the power of the company to register as shareholder any person to whom the right to any shares has been transmitted by operation of law. It follows that an instrument of transfer is not necessary. No formalities like transfer deed, execution, attestation are needed. Legal heirs as shown by the succession certificate are aggrieved persons entitled to seek relief against refusal.

Where the company had accepted transmission in respect of a part of the shares but demanded succession certificate or probated 'will' in respect of the rest of the shares, the CLB held that the company had lost the right to refuse transmission for all the shares. No other person had raised any claim or objection. Thus, for example, in a case before the Supreme Court, the State of Orissa became entitled by devolution to the shares of a *Maharaja,* but the company refused to register the State's representative as a shareholder. BACHAWATJ held that the State became entitled to the shares by operation of law. It was, therefore, a case of transmission and the company was bound to accept the same.

A company was not allowed to refuse the registration of transmission in favor of the legal heir of a deceased member on the ground that he was carrying on a competing business. [S.M. Hejee Abdul Sahib v KNE Co. (P) Ltd., (1988) Comp. Cas 843 CLB and rectification of register of members was ordered.

Where the succession certificate was produced, but the company objected to non- payment of stamp duty, the CLB directed transmission to be carried out. The matter of stamp duty to be sorted out in the court. [Renu Kana Dutt v Gour Nitye Tea and Industries (2007) 135 Comp. Cas 271 CLB]

The executor or the successor also has the right to transfer the shares. Section 109 specially enables the legal representative to effect a transfer even if he is not a member himself. Thus he has an option. But he must decide within a reasonable time. The directors may require him by notice to make up his mind within 90 days and if the notice is not complied with, payments due on the shares may be withheld, until the notice is complied with.

Transmission of Shares Under Nomination [S. 109-B – Indian Companies Act]

The nominee gets the right on the death of the security holder to register himself as the security holder or transfer the securities. His right of transfer will be subject to the same limits and restrictions as the right of the original security holder was. The Board of Directors will have the same right of refusal as would have been there had the securities been transferred by the original holder. If the nominees want to register himself as the holder he should send to the company in writing a notice under his signature accompanied by the death certificate. Since this also amounts to a transfer, it will be under the same restrictions which would have been applicable as if the original holder had made a transfer. Even before he gets himself registered, he will be entitled to all the advantages as to dividend, etc. but unless he gets himself registered as a holder, he will have no right in relation to the meetings of the company. If he does not exercise his right of becoming a security holder or of transferring the securities, the Board of directors may ask him to regularize the matter.

Who Can Become Member?

(a) Minor

Every person who is competent to contract may become a member. A minor and a person of unsound mind being incompetent to contract, cannot be members of a company. According to English law, however, a minor may join a company as a member, but the contract is voidable at his option during minority as well as within reasonable time after the attainment of majority. But as long as it is not avoided it is a valid contract.

In India also a minor may be allotted shares. His name may remain on a company‘s register of members, but during minority he incurs no liability. In *Palaniappa v Official Liquidator* [AIR 1942 Mad 470: (1942) 1 MLJ 425: 201 IC 731].

Shares were allotted to a minor on an application signed on her behalf by her guardian. In the winding up of the company neither the minor nor her guardian were held liable as contributories.

On attaining majority and becoming aware of the presence of his name in the register of members, the minor has the option to repudiate his shares within a reasonable time. Where he does not do so he may safely be taken to have accepted his position. His liability as a shareholder commences. This was laid down by the Bombay High Court in *Fazulbhoy Jaffar v Credit Bank of India Ltd.* [AIR 1914 Bom 128: ILR 39 Bom 331: 27 IC335]. An infant was registered as a shareholder. After attaining majority he received dividends from the company. The Court observed: “Under these circumstances it cannot be doubted that he has intentionally permitted the company to believe him to be a shareholder and in that belief to pay him dividends since he attained majority. He is, therefore, estopped now by his conduct from denying that he is a shareholder”. The company was in winding up.

The erstwhile Companies Tribunal held [in *Navinchandra v Gordhandas and (1967) 1 Com LJ 82: (1967) 37 Com Cas 747*] that if a minor‘s name is entered in the register of members as an allottee, the company cannot afterwards *Suo motu*delete it. Can the minor is entitled to rectification if the company does so. The Delhi High Court in *Golcunda Industries Ltd v ROC*

[AIR 1968 Del 170] has held that the Registrar of Companies cannot refuse to accept a return as to allotment in which a minor is shown as an allottee. The court agreed that the whole law relating to a minor joining a company is still uncertain. There is nothing in the Companies Act prohibiting a minor from becoming the member of a company.

(b) Others Disqualified

Others disqualified would include, for example, persons of unsound mind and insolvents. The position of a person of unsound mind is akin to that of a minor. So far as an insolvent is concerned, if he was a member before, his name can remain in the register not with standing his insolvency, unless the articles provide otherwise.

Sec.66 of the Act makes a provision relating to minors and other persons disqualified under law as follows:

(1) No minor who has yet to attain 16 years of age, or person who is disqualified by law for signing contracts, may become a promoter of anyCompany. However, this section shall not be deemed to have prejudiced the right of a minor or a person disqualified by law for signing contracts to acquire title to any promoter's share as an escheat (aputali) or through the enforcement of law.

(2) In case any minor, or any person disqualified by law for signing contracts, is required to sell or purchase a share or debenture of any Company, the same shall be done by his / her father, mother or husband or wife, or patron or guardian appointed according to law.

Even though, the guardians may sign the application for allotment of shares/transfer of shares, still a person below the age of 16 will not be liable on the contract as discussed above.

(c) Company as Member

A company, being a legal person, may become the member of another company. But a company can invest money in another company only if it is so authorized by its memorandum of association.

A company cannot, however, buy its own shares, except in a limited manner permitted by Section 66. Similarly, subject to a few exceptions given in Sec.62, a company cannot buy shares of its holding company. Restrictions on inter-corporate investments are stated in Section 176.

(d) Trade Union

A trade union registered under the Trade Unions Act, can be registered as a member and can hold shares in a company in its own corporate name.

(e) Partnership

A partnership firm, not being a person, cannot buy shares in its own name. It may buy shares as a part of the assets of the firm, though they will have to be held in the name of individual partners.

Ceasing to be Member

A person may cease to be a member by transfer, death, forfeiture, surrender, on winding up of the company and otherwise in accordance with the provision of the company‘s articles of association.

Liability of members

Most companies are, however, incorporated with the liability of members limited by shares. Each member is bound to contribute the full nominal value of his shares and his liability ends.

Calls on Shares

The liability of a shareholder to pay the full value of the shares held by him is enforced by making ‘calls’ for payment. Every shareholder is under a statutory liability to pay the full amount of his shares as Section 36(2) declares that ‘all money payable by any member to the company shall be a debt due from him to the company’. But the liability to pay this debt arises only when a valid call has been made. For example, in *Pabna Dhana Bhandar Co Ltd v Foyezud Din Mia:* [AIR 1932 Cal 716:140IC 252:36 CWN 589]. It was held that ‘a mere demand by a company acquiring the rights of anothercompany in respect of its uncalled capital cannot take the place of a formal call’.

However, a company can accept voluntary payment of the uncalled amount, if it is so authorized by its articles. Voting rights are, however, regulated only by the amount actually called by the company.

An enforceable call shall have to conform to the provisions of the Act and the articles of association of the company. The following are some of the important requisites of a valid call:

(a) By resolution of board

In the first place, a call must be under are solution of the Board of directors. In making a call care must be taken that the directors making it are duly appointed, and duly qualified, and that the meeting of the directors has been duly convened, that the proper quorum is present and that the resolution making the call is duly passed. However, every small irregularity should not be taken to render a call invalid. To cover minor discrepancies the articles often provide that the acts of directors would be valid not with standing that it should be afterwards discovered that there was some defect in the appointment or qualifications, etc. of such directors. Accordingly, in *Dawson v African Consolidated Land & Trading Co,* [(1898) 1 Ch 6: 77 LT 392] where a clause of this kind existed, it was held that a call made by a resolution of three directors was valid, although one of them had under the articles of association vacated his office by parting with all his qualification shares for a few days. *Shiromani Sugar Mills Ltd v Debi Prasad* [AIR 1950 All 508: (1950) 20 Comp. Cas 296: 1950 ALJ 836] is another illustration: The directors had by not paying allotment and call moneys disqualified themselves, yet their act in making a call was held to be valid. [Ordinarily this should have been regarded a breach of trust and the directors should be compelled to pay as much as other shareholders had paid. See *Alexander v Automatic Telephone Co.* (1990) 2 Ch 56: (1990)-03) All ER Rep Ext 1755].

The company has the power, if so authorized by its articles, to accept from any member the whole or a part of the amount remaining unpaid on any shares held by him, although no part of that amount has been called up. Such payment will not entitle the member to more voting rights as compared with other members until all have been called upon to pay.

(b) Amount and time of payment

Secondly, the resolution must state the amount of the call and the time at which it is to be paid, otherwise the call will be invalid. In *E&W Insurance Co Ltd v Kamala Mehta*: [AIR 1956 Bom537].The directors of a company had, by two resolutions, resolved to make a call. But neither resolution specified the date and the amount of payment. The blanks were subsequently filled by the secretary, who sent a notice of call to the defendant. The call notice was held to be invalid.

(c) Bonafide interest of company

Thirdly, the capital of a company is a trust fund in the hands of directors. The amount called up must be used scrupulously for the objects of the company and the amount uncalled must be called only when it is necessary for the promotion of those objects. Hence the power to make a call is in the nature of a trust and is to be exercised in the interest of the company. Good faith is lacking where, without paying what is due on their own shares, the directors call upon the other shareholders to pay. In such a case the court would require them to pay as others have paid. [*Alexander v Automatic Telephone Co.* (1900) 2 Ch 56: (1900-03) All ER Ref Ext 1755] Similarly, where the directors paid into the company‘s account the amount due on their shares and immediately there after withdrew it as their fee, it was held that the payment was not for the benefit of the company and they remained liable to pay. [*European Central Rail Co. Re,* (1872) LR 13 Eq 255: 26 LT92]

(d) Uniform basis

Section71of Indian Co.s Act provides that ‘calls shall be made on auniform basis on all shares falling under the same classes. Hence a call cannot be made on some of the members only, unless they constitute a separate class of shareholders. Thus where a shareholder paid the first two calls after a great delay and neglected to pay the third call and the directors, being annoyed, called upon him to pay the whole amount due, the call was held to be invalid. [*Galloway v Halle Concerts Society,* (1915) 2 Ch 233: (1914-15) All ER Rep 543] But ―shares of the same nominal value on which different sums have been paid shall not be deemed, for this purpose, to fall under the same class. [Explanation toS.91]

A shareholder on whom a regular call for payment has been served may choose to pay the sum due in respect of only a part of his shares. In the view of the Punjab High Court the debt is not ‘an entire and indivisible debt’, and, therefore, the company may be bound to accept the amount tendered by the shareholder. [*Hind Iron Bank Ltd v Raizada Jagan Bali,* (1959) 29 Comp. Cas 418]

(e) Payment in kind (*Payment by non-cash consideration*)

Shares may be paid for in cash or kind or in any manner that has the effect of actual cash being received by the company. In *Larocque v Beauchemin:* [1897 AC 358: 76 LT 473]. A company purchased a paper mill for 35,000 dollars payable in cash. Subsequently, however, the vendors purchased shares in the company and allowed it to retain a part of the sale proceeds in payment of the shares.

It was held that the effect of the agreement was that the shares had been paid in full in cash as it was not necessary that the company should first receive the share money and then hand it back to the vendor in payment of its debt. Similarly, the company may allow a shareholder set-off- for the amount due to him against his liability to pay for his shares. Thus payment for shares may be in property, goods or services.

Where shares are allotted for any consideration other than cash, that is to say, for purchase of property or in return for services, the company has to file with the Registrar a copy of the contract in writing showing the title of the allottee or other consideration he has given for the shares.

Shares were allotted in return for sugarcane growing land transferred to the company. In the winding up of the company it was alleged that the value of the land was ten times less than the value of the shares allotted.

Even so GROVER J of the Supreme Court, refused to interfere. The learned judge said that there was no allegation of fraud. The facts stated related more to inadequacy of price or consideration and not to its being illusory. There should be no inquiry into the question whether the appellants had paid consideration which was inadequate.

It has been held by the Madras High Court that shares cannot be allotted in consideration of promissory notes. [*Chokkalingam v Official Liquidator*, AIR 1944 Mad 87: (1943) 2 MLJ 499]

Forfeiture of Shares

If a member, having been called upon to pay, defaults, the company may, of course, bring an action against him. But articles of association often provide that in such a case the company may proceed to forfeit his shares. Shares cannot be forfeited unless there is a clear power to that effect in the articles. This in *Madhawa Ramchandra Kamath v Canara Bkg Corpn Ltd:* [AIR 1941 Mad 354. Regulations 29 to 35 of Table A provide for the power of forfeiture]. The articles of a company only authorized it to expel a member. That was held to be not sufficient to enable the company to deprive the expelled member of his shares.

Forfeited shares become the property of the company. To this extent forfeiture involves a reduction of the company‘s capital. The shares can, however, be re-issued, even at a discount, but that is not the same thing as an allotment.

"The right to forfeit shares must be pursued with the greatest exactness". It must be exercised by the proper parties, that is, by directors properly appointed, and by the requisite number of them and in the proper manner and the proper cause. The right must be exercised *bona fide* for the purpose for which it is conferred. The power of expulsion is a trust the execution of which will be narrowly scanned by the courts.‖ [SHADI LAL J (after words, CJ), in *Kanshi Ram v Kishore Chand,* AIR 1915 Lah 109. The learned judge added. ―It (the power of forfeiture) cannot, for example, be exercised surreptitiously for the purpose of expelling a shareholder, nor by connivance for the purpose of assisting him in getting rid of his shares.‖ See also *Esparto Trading Co. Re,* (1879) 12 Ch D 191, where a forfeiture that appeared to have been carried out at the request of a shareholder to relieve him from liability was set aside, *Abdul Karim v Sirpur Paper Mills,* (1969) 1 Comp LJ144]

(a) In accordance with articles

A forfeiture to be valid must proceed on the grounds specified in the company's articles. It seems to be a principle of England law that shares can be forfeited only for a non- payment of calls. A call which does not fix the time for payment cannot support a valid forfeiture. A forfeiture on any other ground would be an illegal reduction of capital. But the Supreme Court has now held in *Naresh Chandra Sanyal v Calcutta Stock Exchange Assn Ltd* [(1971) 1 SCC 50: (1971) 41 Comp Cas 51] that "there is no provision in the Companies Act restricting the exercise of the right to non-payment of calls only".

A stock broker, holding one fully paid share in the Exchange, carried on business on its premises. He had agreed to buy certain shares from a company, but failed to carry out his commitment. The shares were then resold by the company with the authority of the Exchange. The broker was required to pay the difference between the contract and resale prices. On his failure to do so his share was forfeited.

A company may by its articles lawfully provide for grounds of forfeiture other than non-payment of a call, subject to the qualification that the articles relating to forfeiture do not offend against the general law of the land in particular the Companies Act, and public policy; that the forfeiture contemplated does not entail or effect a reduction in capital or involve or amount to purchase by the company of its own shares, nor does it amount to trafficking in its own shares.

The learned judge then stated that the forfeiture of shares did not result in reduction of capital. The company was under an obligation to dispose of the forfeited share, and could not retain the same. Further, the reissue of a forfeited share was not an allotment, but only a sale, for otherwise the forfeiture, even for non-payment of call, would be invalid as involving an illegal reduction of capital.

Where the buses of a transport company were divided into two groups of shareholders, each group operating them separately, and one of them causing losses that would not justify forfeiture of their shares.

(b) Notice precedent to forfeiture

A notice under the authority of the Board of Directors must be served on the defaulting shareholder. The notice should require him to pay the amount on a day specified which should not be earlier than thirty days from the date of service. Under Nepal Companies Act, in addition such notice should be published in the national newspapers three times. The notice should clearly warn him that in the event of non-payment before the time fixed, the shares would be liable to be forfeited. The notice must also specify the exact amount due from the shareholder. Where, for example, the notice of forfeiture claimed interest from the date of the call instead of the date fixed for its payment, it was held to be a bad notice and the forfeiture invalid. "This seems to be some what technical. Butin the matter of forfeiture of shares, technicalities must be strictly observed". "Averylittle inaccuracy is as fatal as the greatest". It has been held by BACHAWAT J in a decision of the Supreme Court, [*Public Passenger Service Ltd v Khadar,* (1965) 1 Comp LJ 1: AIR 1966 SC 489: (1966) 36 Comp Cas 1: (1966) 1 MLJ 23] that a notice which does not specify the amount claimed by the company as call money, interest and expenses, is defective. 'The defect in the notice, though slight, invalidates it and is fatal to the forfeiture'. In a case before the Delhi High Court, [*Promila Bansal v Wearwell cycle Co (India) Ltd,* (1978) 48 Comp Cas 202 Del] shares were forfeited on the basis of a registered acknowledgement due notice which came back as unserved, it was held that the forfeiture was bad, for it was the duty of the company to know whether the address of the member had changed. The fact that forfeited shares had been re-allotted to others was held to be no defence and the member was entitled to have her name put back in the register for the same shares which she held before forfeiture. Even latches or delay on the part of the shareholder in protesting against the forfeiture was held to be not sufficient to disentitle her from her remedies.

(c) Resolution of forfeiture

The above notice does not by itself operate as forfeiture. The directors have further to pass a resolution declaring the forfeiture. Thus, where the final resolution of forfeiture was not passed the court held that, 'a declared intention to forfeit not carried intoeffect is no forfeiture at all'. But the notice threatening forfeiture may incorporate the resolution of forfeiture as well. It may state that in the event of default the shares shall be deemed to have been forfeited. In such a case no further resolution is necessary.

(d) Good faith

Lastly, 'the object of a power of forfeiture is that the company shall be enabled, for its own benefit, and adversely to the shareholder, to forfeit his shares it he fails to pay his calls. The power cannot be used at the request of the shareholder to relieve him of shares. The power must be exercised in good faith in the interest of the company.

(e) Right and liability after forfeiture

The liability of a member whose shares have been forfeited depends upon the provisions of the articles. The articles may provide that the member should be liable to pay all calls owing upon the shares at the time of the forfeiture. In such a case the members will remain liable as a debtor of the company, but not as a contributory, even if the winding up follows more than one year

after the forfeiture. He, however, remains a contributory as a past member for one year from the date of forfeiture.

A person to whom forfeited shares have been reissued is governed by the terms of reissue. When the reissue is without any stipulation as to the outstanding calls, the new allottee cannot be held liable for the previous calls and interest on the overdue amount and his shares cannot be forfeited on that ground.

Companies Act, 2063 has differed to a certain extent from the above in respect of forfeiture. As per section 53 of the Act, an amount for a share shall be paid up within the period of a call made in accordance with the articles of association. In making such call, a company shall send every shareholder a written notice, in the prescribed format, specifying a time limit of at least thirty days and the installment payable by him/her, the place and time for payment. A public company shall also publish such notice, for at least ***two*** times, in a daily newspaper with national circulation.

Apart from the first notice of call, if the amount of call is not paid by thirty days given by the notice, a second notice has to be given stating specifically that the share will be forfeited if the amount is not paid before the day which shall not be less than thirty days of the notice and the notice has to be published in the national newspapers three times. If the call amount is not paid even then, then the company can make fully paid shares up to the amount so far received along with any dividends payable and forfeit the balance shares or forfeit the whole shares. If the company has become insolvent or wound up before the call is made, then the unpaid amount of the call money due on the shares can be collected as a debt due to the company [Sec 53(3)]. The Board of directors can decide to issue fully paid shares for the amount received and any dividends payable on such shares or to refund the amount received along with the dividend payable on the forfeited shares to the member. If the Board decides to refund the amount, the same should be returned within three months. If it is not so paid within that period then the amount should be paid along with interest from the expiry of three months [Sec. 53(4&5)]. The Board of Directors, subject to the articles of association may as they deem fit, sell or otherwise disposed of in such manner the forfeited shares [Sec 53(6)].

Surrender of Shares

Every surrender of shares, like forfeiture, amounts to reduction of capital. But, while forfeiture is recognized by the Act, surrender is not. There is no reference in the Act to surrender of shares; but these have been admitted by the courts, upon the principle, that they have practically the same effect as forfeiture, the main difference being that one is a proceeding *in invitum* and the other a proceeding taken with the assent of the shareholder who is unable to retain and pay future calls on the shares. Hence a company can only accept a surrender under conditions and limitations subject to which shares can be forfeited.Avalid call and a default must exist and the directors may, instead of going to the length of forfeiture, in good faith accept a surrender from the shareholder. Surrender should not be used as a device for relieving a shareholder from his liability. [Following cases are illustrations of bad surrender of shares: *Collector of Moradabad v Equity Insurance Co.* AIR 1948 Oudh 197. In this case, after the death of a Raja who held several shares in a company, his shares were surrendered to the company and the surrender was

accepted by the secretary of the company. It was held that 'even if the secretary intended to accept the surrender, the transaction would be *ultra vires*. Under our law it is not open to a shareholder to surrender the shares held by him, or to the company to accept the surrender, unless the act of the company can be brought within the rules relating to forfeiture of shares'. Yet another case is *Mangal Sain v Indian Merchants Bank, Amritsar*, AIR 1928 Lah 240. The director having been placed in the list of contributories in the winding up of a company contended that he had surrendered his shares, and that the directors had, under a clear power in the articles of association, accepted the surrender. It was held that a company can only accept a surrender under conditions and limitations under which shares can be forfeited, which did not exist in the present case, See also *Mirza Ahamad Namazi, Re*, AIR 1924 Mad 703: *Bellerby v Rowland & Marwood's Steamship Co.* (1902) 2 Ch 14: (1900-03) All ER Ref Ext 1290. Where old shares are surrendered to get new one of the same value that is not a surrender, for it does not involve reduction of capital or of liability. *Rowell v John Rowell & Sons Ltd*, (1912) 2 Ch 609:107 LT 374] But surrender is not recognized in Nepal and India under the companies Act unless there is a provision in the Articles of the concerned company.

Shareholder Register [Sec. 46]

Every company is bound to keep a shareholder register, which should contain the following particulars:

(a) The full name and address of each shareholder (and his occupation);
(b) The number of shares held by each shareholder and the extent to which the shares have been paid up. and the balance amount to be paid. Each share shall be distinguished by its appropriate number; the class of shareholders to which the shareholder belongs should be indicated;
(c) The date at which he was entered in the register as a shareholder;
(d) The date at which any person ceased to be a shareholder; and
(e) The name and address of any nominee, if any, to whom the shareholder wants the right to the shares to go after his death.

The register may be in the form of a bound book or a computer record. Required particulars shall be recorded and adequate precautions shall be taken against tampering. Companies with more than fifty members are required to maintain an index of shareholders. The register itself may be kept in the form of an index or a separate card index may be used for the purpose. This is to enable entries relating to a particular shareholder to be readily found. Any change in the register shall be noted on the index within thirty days.

Place of Keeping, Inspection and Closure of Register [S. 46(1) (4), (5), (6) and (7)]

The appropriate place for keeping the register is the registered office of the company. Every shareholder and a debenture holder has the right of inspection without fee but a prescribed fee can be charged from any outsider who wishes to inspect. This is to enable persons dealing with the company to ascertain for themselves the share ownership of the company. The company may, however, impose reasonable restrictions on the right of inspection, but the register shall remain open for at least during business hours each day. The right to inspect also includes the right to make extracts from the register. The company is also bound to supply on demand a copy of the register. Thus in *British India Corporation Ltd v Robert Menzies*: [AIR 1936 all 568: 1936

ALJ 748: 164 IC387]. A member applied for a copy of the register of members. The company received from him a fee of five hundred rupees, but put him off under pretexts of many kinds. On his application to the High Court, the latter ordered the company to supply a copy immediately. The court said: It is fundamental principle of legal administration that where the law requires something to be done there must be in existence a court that can directly order it to bedone.

But the register may be closed for a maximum of forty five days but not more than 30 days at a time by a public company by giving notice of at least seven days in a national newspaper. This will usually be controlled by the provision in the Listing agreement where the public company shares are listed in the stock exchange. In the case of private company, it will be governed by the provision in its articles of association. Usually the register is closed before any general meeting in order to ascertain the voting rights of the members on the date of the meeting and for ascertaining the shareholders to whom the dividend, if any, to be paid or a notice to be sent.

The company may charge a fee for giving copies of the register and should provide them except when the register is closed as above.

A listed company may, instead of itself keeping the register, entrust the work of keeping the register of members to an approved securities registrar, who provides the services of depository of securities. But, a copy of such register shall be kept open at the registered office before the issuing of notice for annual general meeting. Similar provision is applicable in the case of debentures also.

Sec. 46(7) provides for punishment to the registrar for not keeping the register correctly. If any false entry or information is recorded by the registrar in the shareholder register or debenture holder register, then the registrar entrusted with the work of maintaining the register along with its directors, officers and employees shall be liable for punishment of keeping false records under sec.160(1) with fine from Rs 20,000 toRs.50,000 or imprisonment upto 2 years or both. In addition, if any loss is caused to any person by any such false entry, then that loss also should be compensated.

Rights of Others on the Shares Held by a Shareholder

Section 47 of the Companies Act gives the right to the company to ask for details of the person entered in the register as shareholder to ascertain the real owner of shares. The company can ask for the following details:

(a) In what capacity the shares were acquired by him,
(b) Is there any other person‘s investment in the shares or not,
(c) If any other person is beneficiary of such shares, then identity of that person,
(d) The nature of the rights of such beneficiary.

The registered shareholder has to furnish the information demanded within thirty days to the company. On receipt of such information, the company shall have to make the following entry in the register along with the name of the shareholder:

(a) The date when information was demanded,
(b) The date when information was received,
(c) The particulars received.

After entering the particulars in the register, within seven days the information shall be furnished to the OCR also.

Lien on Shares Section 52 of the Act provides that a company may attach a share registered in the name of a shareholder and dividends payable thereon, as well, for all moneys due and payable by him/her to the company in respect of that share or for all moneys due and payable by him/her to the company under the prevailing law and recover such moneys by deducting the same from the dividends.

"It is eminently fair for a company to provide by its articles, that the shareholders who are indebted to the company should not be permitted to dispose of their shares without paying their debts and that the company should have a lien on the shares for the debts". Lien is the right to retain some property for some debt and in the case of a company, lien on a share ultimately means that the member would not be permitted to transfer his shares unless he pays his debt to the company. The right of lien is not inherent, but must be clearly provided for in the articles. The effect of lien on shares may be illustrated with the case of *Amar Nath v Karnal Electric Supply Co* [AIR 1952 Punj411]. A company had by its articles the first and paramount lien on the shares of each member for his debts to the company. The company was in liquidation and the plaintiff was a contributory. The liquidator was ordered by the Court to pay back half the value of each share to contributories, but he had not paid this amount to the plaintiff who brought an action to recover it. The liquidator contended that the company had a claim against him for which proceeding under Section 235, 1913 Act were pending and that he was withholding the payment in the exercise of the right of lien. He was held entitled to do so until the company's claim was settled. The mere fact that the claim was disputed could not suspend the lien for otherwise 'any shareholder has only to dispute the liability and thereby to defeat the lien'.

Postponement and Loss of Lien

A company's lien will, however, be postponed if the shareholder has mortgaged or pledged his shares before he has incurred any debt to the company and the company has notice of it. Thus where certain shares were subject to a 'first and paramount lien' were given to a bank as security for an overdraft and the bank had given notice to the company, it was held that the bank had priority over the company's claim which arose subsequently. Notice obtained by the directors in the course of business will definitely amount to notice to the company. But if a director knows about the mortgage in his private capacity, will that operate as a notice to the company? The High Court of Allahabad has held that it would. The case is *U.I. Sugar Mills Co Ltd, Re.*[AIR 1933 All 607: 1933 ALJ 1322: 146 IC801]. The liquidator of a company had a surplus and he proposed to divide it among the shareholders. The company had lien on shares. The managing director was indebted to the company for a large sum of money but he had mortgaged his shares before the commencement of winding up. Neither he nor the mortgagee had given notice to the company. As against the managing director the company was clearly entitled to exercise its lien on the amount payable to him. But the mortgage claimed the amount on the ground that as the

managing director had himself pledged the shares, his knowledge amounted to notice to the company. The court upheld this contention and said: 'The company shall be deemed to have knowledge of such transaction when the managing director who has all powers of the board has himself pledged his shares, although in his private capacity'.

The decision amounts to this that knowledge obtained by a managing director in the course of a private transaction of his own amounts to notice to the company. The only case cited as an authority in support of this view is *Rainford v James Keith & Blackman Co Ltd*, [(1905) 2 Ch 147] but in this case the facts were entirely different. A shareholder who was also a servant of the company had informed the directors that his shares were with someone else from which, the court said, the directors should have inferred that they must have been pledged.

Where the holder of shares is a trustee, the company's lien will prevail over the claim of the beneficiary unless he has given notice to the company before any occasion arose for enforcing the lien. A company's claim against the beneficial owner of shares cannot entitle the company to exercise the right of lien against the trustee-holder of those shares. Where the right to exercise the lien has arisen and the shareholder transfers a part of his shares, the transferee can insist that the company should satisfy its claim to the extent possible from the shares remaining in the hands of the shareholder. Lien remains effective even after the death of the shareholder and can be exercised against the executors.

Annual Returns [Sec. 78]

Every public company has to file with the Office of Company Registrar an annual return containing particulars stated under section 78 of the Act. This is to enable the Office of Company Registrar to record the changes that have occurred in the constitution of the company during the year. The return of a company having share capital has to contain the following particulars regarding:

(a) Number of shares allotted;
(b) Out of the shares allotted, number of hares paid and not paid;
(c) Details of the directors of the company, the managing director, auditor, chief executive and manager and the details of remuneration and other facilities provided to them;
(d) Names of the persons or corporate body holing shares of 5% and more of its paid up share capital and the number of shares and debentures held in their name;
(e) The total amount received by sale of shares, and the number of shares and debentures issued and purchased during the concerned financial year;
(f) Amounts to be paid to the company by any director or basic shareholder or his relatives;
(g) Any amount to be paid in respect of sale of shares or for any other work done;
(h) The loans taken from banks and financial institutions ,the total amount of principal and interest outstanding to be paid;
(i) Any claim made by the company to receive any sum or claims received against the company or if any case is pending , particulars of the same;
(j) The number of employees or workers engaged in the management of the company;
(k) The number of foreigners employed in the management of the company or un other capacity and the remuneration and facilities provided to them;

(l) If there is any agreement s agreement is made for a period exceeding one year between the company and any foreign body or persons with regard to investment, management or technical services or any other matter, the details of these and during the concerned financial year the details of the amount of payment made in the form of dividend, commission, fee or royalty etc.
(m) The details of the administrative expenses of one financial year;
(n) details of unpaid dividends still to be received by the shareholders;
(o) Declaration that the company has complied in full with the Companies Act and other prevailing laws;
(p) Any other necessary matters.

The return has to be filed at least twenty one days before the date of the annual general meeting. It must be approved by the board and signed both by a director and the auditor of the company.

Evidentiary Value

Where the holding of a given percentage of shares is a requisite qualification for exercising certain rights under the Companies Act, entries in the annual returns can serve as evidence for the purpose. The annual return has been held to be not a conclusive evidence of ownership. It serves only as a *prime facie* evidence. Its contents can be over thrown by evidence to the contrary.

11 GENERAL MEETING

General meeting means the meeting of shareholders of a company. As per the Act, every public company shall hold the general meeting. However, in case of private companies, holding such general meeting depends upon the provision mentioned in its Article of Association. If the private company does not hold the general meeting for making any decision authorized to be made by the GM, then its AoA shall expressly provide who shall be authorized to make such decision.

Type of GM:

As per Section 67(1) of the Act, the general meetings of a company shall be as follows:
(a) Annual general meeting, and
(b) Extra-ordinary general meeting.

Time of GM:

Regarding AGM, Section 76 of the Act has provided that every public company shall hold its first annual general meeting within one year after it is permitted to commence its business, and there after it shall hold the annual general meeting every year within six months after the expiry of its financial year. Further, p*rivate companies providing annual general meeting in its article of association shall also hold AGM within 6 month after the expiry of each fiscal year.*

The Act does not prescribe for holding the annual general meeting compulsorily to private companies unless the same is required under its Articles of Association or consensus agreement concluded among the shareholders.

If any Company fails to hold this annual general meeting within the time limit provided under sub-section (1) of Section 76, the Company is allowed to hold the meeting within 3 months from the expiry of such 6 months from the close of each financial year. If it is not so held then the Registrar may give direction to hold the Annual General Meeting and it shall be held in accordance with the directions given. Such annual general meeting shall be held within three months from the receipt of the direction. If it is not so held, any shareholder may file an application with the Court. In that case, the Court may order to hold the annual general meeting or any other appropriate order.

Failure to call a general meeting is an offense punishable with fine from Rs 10,000 to Rs 50,000under Section 161(h) of the Act. Consequently, the the person who commits such offence shall be personallyliable to pay the fine.

The penalty is imposed upon the company as well as every officer 'who is in default'. Thus, for example, in *Shree Meenakshi Mills Co. Ltd* v *Asst Registrar of Joint Stock Companies* [AIR 1938 Mad 640: (1938) 1 MLJ 856:39 Cri LJ907]. A company was prosecuted for failure to call an annual general meeting. One general meeting was called in December, 1934. This was adjourned to March, 1935 and then held. Subsequent meeting was held in February, 1936. The prosecution was for not holding a meeting in 1935. It was contended on behalf of the company that a meeting was held in that year.

But the court held that the meeting of March 1935, was the adjourned meeting of 1934. 'There should be one meeting per year and as many meetings as there are years'. The company was accordingly convicted. Similarly, in another case, [*Brahmanberia Loan Co. Ltd., Re,* AIR 1934 Cal 624: 151 IC 693: *See also Ramchandra & sons (P) Ltd. v State,* (1967 2 Comp LJ 92] for a failure to hold a meeting it was held to be no defense that on account of a criminal case against the secretary of the company some important books were exhibited in the court and as they had not been released in time, no accounts could be prepared, and no meeting could be held. But in *Kastoor Mal Banthiya v State*: [AIR 1951 Ajm 39], the accused and his brother were the only two members and directors of a private company. During the period when a meeting should have been held his brother was lying seriously ill and the consequent failure to hold the meeting was not considered to be a will ful default.

Where a managing director has been pressing his colleagues to call the annual general meeting but in vain, he cannot, for the purpose of this section, be described to be an 'officer in default'. [*S.S.Jhunjhunwala v State,* (1970) All WR 814]

The Registrar has been given the power, for any special reason, to extend the time for holding an annual general meeting for a period of only three months. But the time for holding the first annual general meeting of a company is never extended. [Proviso to S. 166(1) (c) India Act. See *Dalmia Cement (Bharat) Ltd. v Registrar of Joint Stock Companies,* AIR 1954 Mad 276. The

power of extension cannot be exercised by the Central Government, *Nungabakkam D. S. Nidhi Ltd* v *ROC,* (1972) 42 Comp Cas 632 Mad. The Central Government also cannot examine aspects of validity; that is a matter for civil courts. *Ravinder Kuamr Jain v Punjab Regisrtered (Iron and Steel) Stock Holder Ass,* (1978) 48 Comp Cas 401P&H]

Place of GM:

Such general meeting of a public company shall be held normally in the district in which its registered office is situated or the adjoining district in which majority of shareholders are residing. If the company wants to hold the meeting at any other place, it can hold the meeting after taking prior permission from the Office of Company Registrar.

In the case of private companies, the general meeting of the company can be held at any place within or outside Nepal unless its Article of Association provides otherwise [Sec67(4).]

Under the Indian Companies Act Sec. 166(2) provides that every annual general meeting shall be called during business hours on a day that is not a public holiday. But in the Companies Act, there is no such prohibition and the annual general meeting can be called even on a holiday and during non-office hours i.e. before 10 AM and after 5 PM. But in India, the Central government may exempt any class of companies from such provision subject to such condition. Further a public company or a subsidiary of a public company may by its articles of association fix the times for its annual general meeting and may also by a resolution passed at one annual general meeting fix the time for its subsequent annual general meeting. A private company also which is not a subsidiary of a public company may by a resolution agreed to by all the members thereof, fix the time as well as the place for its annual general meeting.

PROCEDURE AND REQUISITES OF VALID MEETING

(a) Meeting shall be Called by Proper Authority

The first essential requisite of a valid meeting is that it should be called by a proper authority. Obviously the only proper authority is the board of directors, except when the meeting has, in the event of default by the directors, been caused to call by Court, OCR or other requisitionists. Suppose, for example, that the meeting of the board at which it is resolved to call a general meeting is not properly convened or constituted, will it render the general meeting also invalid? It was held in *Browne v La Trinidad* [(1887) 37 Ch D 1: 158 LT 137 CA. The court does not have the power to give directions for the conduct of a meeting already called by the directors. *R. Rangachari v S. Suppiah, I (*1975) 2 SCC 605: (1975) 45 Comp Cas 641] that by reason of irregularity of the board meeting the general meeting was not incapacitated from acting. But in the case of *Harben v Phillip* [(1883) 23 Ch D 14: 48 LT 334: 31 WR173].

Certain directors held a meeting of the board but they prevented some lawfully constituted directors from attending the meeting. A quorum was, however, present. It was held that as the meeting of the board was unlawful, the notice convening the general meeting also became invalid. Directors have to exercise their discretion and have to fix the time and place or whether the meeting should be held at all.

(b) Notice

The second requirement of a valid general meeting is that a proper notice of the meeting shall be given to its shareholders. Such notice shall be given to every shareholder of the company. Deliberate omission to give notice even to a single member may invalidate the meeting, although an accidental omission to give notice to, or non-receipt of it by, a shareholder will not be fatal in case of a listed company. This is based upon the theory that the acts of a corporation are those of the major part of the corporators, corporately assembled. By 'corporately assembled', it is meant that the meeting shall be one held upon notice which gives every corporators the opportunity of being present. Secondly, notice should be in writing and must be given at least twenty-one days before the date of the annual general meeting and at least fifteen days before the extra ordinary general meeting

Sec.15(3) provides that any notice to be sent to the shareholders by a company may be sent as laid down in the Articles of Association or it can be sent through electronic medias to these shareholders who consent to the notice being sent through such media at the e-mail address or fax address given. But to the shareholder who do not consent to such notice being sent through electronic media, the same should be sent through reliable media.

If the person entitled to the notice expresses before or after specified time in writing that the notice is not necessary, the notice shall be deemed to have been received by him under sec.181(1). Under sec. 181(2), if a person is present at any meeting either personally or through proxy, he shall be deemed to have given up his right to receive the notice.

(c) Length of Notice for Calling General Meeting

Under the Indian Act, notice for holding any general meeting is 21 days. This will exclude the date of notice and the date of the meeting i.e. there should be clear 21 days before the date of the meeting of notice.

The gap should be of twenty-one clear and whole days. It has been held by the Madras High Court *Self-Help Private Industrial Estates (P) Ltd. Re,* [(1972) 42 Comp Ca 605 Mad] following section 171, that all the members can, in the case of an annual meeting, voluntarily consent to a shorter notice either before or after the meeting. In the case of any other meeting the consent of the holders of the 95% of the paid-up share capital, or the consent of 95% of the total strength of members, would be necessary. Where a special, resolution to shift the registered office was passed at a meeting of which shorter notice was given, the court ignored this fact as there was sufficient evidence of ratification by the requisite number. The fact that one of the members is not traceable does not make the consent less unanimous. Similarly, it has been held in *Bailey, Hay & Co Ltd. Re,* [(1971) 1 WLR 1357:(1971) 3 All ER 693] that a notice of a resolution for voluntary winding up had become valid through acquiescence of the company's members, all of whom attended the meeting despite the fact that it was defective, being short by a day. The Bombay High Court has been of the view that the requirement as to length of notice is merely directory and not mandatory. Where no prejudice whatsoever was caused to the member who complained of the notice being short by one day, the court refused to invalidate the meeting and

its proceedings. The shareholder who participated in the meeting, accepted dividend as well as directorship, was not allowed to question the validity of the meeting on account of short notice.

But under Sec 67(2) of the Nepal Act, the length of notice for calling annual general meeting is at least 21 days and at least 15 days for extra-ordinary general meeting. Further the notice shall specify the place and date of the meeting and the matters to be discussed. Such notice shall also be published in the National level daily Newspapers for at least twice.

If the general meeting is adjourned and if it is to be called, it is enough if at least 7 days prior notice of the general meeting is published in the National level daily newspapers, provided there is no other new matters to be discussed than what was to be discussed in the original meeting.

A notice for an extraordinary general meeting was served by fax. This was held to be good service.

A private company's AoA may contain its own special provisions as to duration of notice. If it is not mentioned, the provision contained in this section 67 shall apply to it as well.

Contents of Notice [Sec.172 and 173 of the Indian Companies Act]

Notice shall specify the place and day and hour of the meeting and the meeting to be valid must be held at the place and time specified, except, perhaps, in a situation that arose in *M.R.S. Rathnavelusami v M. R. S. Manickavelu Chettiar:* [AIR 1951 Mad 542 (1951) 1 MLJ 5:64 LW 172:1951) 21 Comp Cas93]. On the failure of the directors of a company to call a meeting on a requisition, the requisitionists themselves sent a notice to all the members for a meeting to be held at the registered office of the company. But the managing director locked the premises of the registered office. It was held that a meeting held at some other place and the resolutions passed threat were valid.

Again, the notice must contain a statement of the business to be transacted at the meeting.

(a) General business- At the annual general meeting, the business of considering auditor's and director's report, the declaration of dividends, the appointment of directors and auditors and fixing their remuneration etc which require to be passed as ordinary resolution are regarded as general business.

(b) ***Special business-*** Any other business at an annual meeting like amalgamation, liquidation of company etcwhich require to be passed as special resolution under section 83 of the Act are regarded as special business.

Further issue of capital, being a special business, required to be mentioned in the notice. Not to have done so rendered the meeting, its notice and the further issue to be invalid.

Explanatory Statement

If any special business is to be transacted at an annual meeting, a statement to that effect must be annexed to the notice calling the meeting. The statement must set out all the material facts concerning each item of the special business and should also disclose the interest of any director or other managerial personnel in the matter. "Notice must give a sufficiently full and frank

disclosure to the shareholders of the facts upon which they are asked to vote". The purpose of the explanatory statement is that the members should be informed of the nature of the business to be transacted at the meeting. To take, for instance, *Narayanlal Bansilal v Maneckji Petit Mfg Co Ltd* [(1931) 33 Bom LR 556: See also *M. R. Goyal v Usha International Ltd*, (1997) 27 Corpt LA 187 (Del), explanatory statement not found to be tricky, complainant minimal shareholder, no harm to his small holding]. A company had managing agents. It wanted to adopt a new set of articles changing the terms of their appointment. The notice convening a meeting of the shareholders for the purpose set out the proposed special resolutions, but did not give particular of the important changes to be effected. Accordingly the resolutions passed on the basis of this notice were held invalid.

Similarly in Bimal Singh Kothari v Muir Mills Co. Ltd [AIR 1952 Cal 645: ILR (1954) 1 Cal 185: 56 CWN361],It was held that where there is a large body of shareholders residing at great distances from the registered office of the company, it would not be fair to leave the proposed articles at the registered office and give the shareholders notice of that fact. Printed copies of the new articles should be sent with the notice. Where this is not done, the notice is not sufficient.

Where a notice calling a meeting stated that the object of the meeting was to adopt an agreement for the sale of one company's undertaking to another, but did not disclose that a substantial sum was payable to the directors of the selling company as compensation for loss of office, the court held that the notice did not fairly disclose the purpose for which the meeting was convened. Where the shareholders resolution became necessary for selling a unit of the company, the court said that material facts could comprise of the reasons for sale, whether sale would affect the interest of the company, to whom the sale was being effected, the consideration for it, how and by whom the consideration was assessed, whether directors had any interest in the transaction, whether all statutory clearances were obtained. Such material facts would help the shareholders to make a decision on the proposal. The Supreme Court order restraining the company from the sale of its assets has been held to be a material fact. Non-disclosure of such material fact in the notice calling the meeting vitiated the resolution passed at the meeting. An agreement of sale entered into on the basis of such resolution was not enforceable. No action lay for compensation for each of the contract.

It was pointed out by their Lordships of the Judicial Committee in *Parsuram v Tata Industrial Bank Ltd.* [AIR 1928: PC 180. See also Misra J of the Orissa High Court in Kalinga Tubes Ltd v Shanti Prasad Jain, (1964) 1 Comp LJ 117, 138: Shalagram Jhajharia v National Co (1965) 1 Comp LJ 112 Cal] that a shareholder who by his conduct shows that he knew the real effect of the work to be transacted at a meeting cannot complain of the notice on the ground of insufficiency later.

Matters to be Discussed

Under Sec. 67(3) on matters other than those given notice of while calling the meeting no decision shall be taken at the meeting. So the discussion and decision of the meeting are confined only to the matters notified in the notice calling meeting. But exception is made to this rule i.e. matters not previously notified that could be discussed at a meeting. The conditions are that at least shareholders representing 67% of the shareholders entitled to vote are

Present in person or by proxy at the general meeting and they vote in favour of discussing the matter.

Further record showing a list of the name of the shareholder name, address and the number of shares held by them should be kept at the meeting place for the inspection of the shareholders. If the company fails to provide such list, the person responsible (including Directors, officers and other person) will be liable to a fine of Rs.10,000 to Rs.50,000 under Sec. 161(h).

Further, the meeting shall discuss first the items mentioned in the agenda notified along with the notice calling the meeting. If any matter other than those mentioned in the agenda is to be discussed, the same shall be decided after finalizing the matters provided in the Agenda [Sec 67(6)]. Hence, if a shareholder gives notice of a resolution, the same can be taken up only after the agenda items already notified along with the notice calling the meeting are taken up and completed.

Chairman [Sec. 175] Indian Companies Act

For the proper conduct of business at a meeting a chairman is necessary. His appointment is usually regulated by the articles of association. But if there is nothing in the articles the members personally present at the meeting shall elect one of themselves to be the chairman.

Power of adjournment and postponement

The position and powers of a chairman were explained by the Madras High Court in *Narayan Chettiar v Kaleeswara Mills* [AIR 1952 Mad 515: ILR 1952 Mad 218: (1952) 1 MLJ 18. Other powers and privileges of the chairman will become apparent from the discussion on the procedure of voting. For further discussion on the chairman‘s power to adjourn meetings see *John v Rees,* (1969) 2 WLR1294]

If the chairman unjustly and without the consent of shareholders stops the meeting, it is perfectly within the powers of the meeting to elect another chairman and conduct the remaining unfinished business.

A chairman by himself cannot postpone a meeting. The proper course to adopt is to hold the meeting and then adjourn it to a more convenient date, if quorum is not attained. An adjournment will be within his competence in the case of a disorder but only for no longer than he considers absolutely necessary and his decision should be communicated to the meeting at least to the extent to which it is possible for him to do so. If the chairman adopts any other course, the members who can constitute a quorum may continue with the meeting and lawfully transact the announced business. Where the chairman was a candidate for being appointed as managing director and, on finding that he wouldn‘t get majority support, dissolved the meeting and left the hall with his supporters, the appointment by the remaining members, being in quorum, of another person, as a managing director was held to be valid.

The Calcutta High Court in its decision in *United Bank of India v United India Credit and Development Co. Ltd.*[(1977) 47 Comp Cas 689 Cal. Frank Shackleton, LAW AND PRACTICE

OF MEETINGS, 69 (3rd Edn.); Catesby v Burnett, (1916) 2 Ch 325; Deodutt Sharma v Zahoor Ad, 1960 RLW 486: AIR 1960 Raj 25; Nation Dwelling Society v Sykes, (1894) 3 Ch 325; *United Bank of India v United India Credit and Development Co. Ltd. (1977) 47 Comp Cas 689 Cal; Jackson v Hamlyn, (1953) 1 All ER 887* applied.] recognized a chairman's right to make a *bona fide* adjournment but immediately added remarks from the authorities to the effect that if the intention and effect were to interrupt and procrastinate the business, such an adjournment would be illegal; if, on the contrary the intention and effects were to forward or facilitate it, and no injurious effects were produced, such an adjournment would be generally supported. [Citing John v Rees, (1969) 2 WLR 1294: (1969) 2 All ER274]

Mixed Nature of Duty

Further, it has been held in *Ram Narain v Ram Kishen* [(1911) 10 IC 515] that: A chairman who presides over a meeting of a company is neither wholly a ministerial officer nor wholly a judicial officer; his duties are of a mixed nature, and he is not liable to be mulcted in damages, if, acting *bona fide* according to the best of his judgment and without malice, he erroneously excludes a shareholder from voting and declares him to be ineligible as a director of the company. A shareholder who has been wrongfully refused the right of voting or of election as a director, cannot maintain an action of damages against the chairman of the company.

Where a shareholder pledged his shares with a bank with voting rights and the bank lodged the documents with the company for the purpose of exercising voting rights, it was held that the chairman had no power to examine validity of the documents.

Casting Vote

In the case of a tie of votes, the chairman can exercise a casting vote. This right can be exercised by the person who is occupying the chair. It is not necessary that he should be a regularly elected chairman.

The chairman can adjourn the meeting as may be necessary [67(7)]. But this right has to be exercised equitably according to the general trend of the meeting. He is entitled to adjourn the meeting temporarily and resume after some time or adjourn it to some other day or adjourn sine die i.e. without fixing any date. At such adjourned meeting, the matters left over at the original meeting as well as matters on which proper notice has been given after the original meeting also can be considered.

The adjourned meeting will be at par with the original meeting. But any resolution passed at the adjourned meeting will be treated as passed on the date of the adjourned meeting.

Any corporate body who is a member of another body corporate can appoint its representative to attend the meeting of the latter Corporate Body. The appointment should be made by a resolution passed at the meeting of the former company. Such representative can attend, take part and vote at that meeting on behalf of the company. Such representative can appoint a proxy, if he is not able to attend the meeting for any reason and will have the same right to attend and vote at the meeting.

If due to some mistake any notice is omitted to be given to any shareholder or notice sent to the address given by the shareholder was not received by him by reason only of such omission, the validity of the shareholders meeting will not be affected. But not sending notice should not be motivated by male fide intention. In the case of private companies, if no provision is made either in the Articles of Association or common consent agreement, regarding the general meeting, then the provisions of the Act shall apply.

Proceedings at the general meeting shall be as laid down in the Articles of Association of the Company. Like electing chairman, proposing resolution, counting of votes etc. At general meetings of the company, every director of the company should be present as far as possible, i.e. he may not attend if he is sick or not in town due to some other business of his etc. Any director owing to circumstances beyond his/her control, may attend and vote in the general meeting through video conference or other such technology under section 68.

Constitutional Validity or Competence of the Meeting

Before commencing the meeting, the shareholders present shall be assured that the meeting has been called in accordance with this Act and its Articles of Association. In this connection even if the provisions of some other law is not complied with but if the meeting has been called by giving the necessary notice of 21 clear days and 15 clear days in respect of Annual General Meeting and Extra-ordinary general meeting respectively and if the number of members required to form quorum is present and agree to the conduct of the meeting, then the meeting shall be deemed to have been validly called and can be validly conducted.

Quorum (Sec. 73)

Another requirement of a valid meeting is the presence of a quorum. Quorum means the minimum number of members that must be present at the meeting. It is generally for the articles of association to provide what number of members will constitute a quorum.

In the case of private companies, quorum shall be as mentioned in its Articles of Association. In the case of single shareholder Company requiring general meeting to be convened one person s constitute quorum. But, in the case of a company promoted by another public company and in the case of public company incorporated under Sub-section (1) of Section 173, the quorum can be less than three or even one.

Sub-section (1) of Section 173 provides that if the GoN wishes to convert a publiccorporation incorporated under the prevailing law, fully or partly owned by the Government of Nepal, or a development board formed under the Development Board Act, 2013 into a company, such corporation or board can be converted into a public company and incorporated under this Act.

Quorum for a public company shall be the presence of shareholders holding more than 50% of the total allotted share units of the company representing not less than three shareholders in person or through proxy. Thus, as a minimum one member and two proxy persons or two shareholders and one proxy person or three proxy persons shall be present at the meeting personally, if three shareholders could not be present personally.

If due to reason that quorum was not present, the meeting had to be adjourned, the quorum at such adjourned meeting, is that, at least shareholders representing 25% of the share units allotted and being not less than three in number should be present.

In this, Indian Companies Act is simpler.

Indian Act	Nepal Act
1. Unless higher member is prescribed in the Articles: 5 members personally present in the case of public company. 2 members personally present in the case of private company.	1. In the case of public company: shareholders holding more the 50% of the total share units allotted representing not less than 3 persons present personally or through proxy. In the case of private company as provided in the Articles of Association of the company.
2. If quorum is not present within half an hour after the commencement of the meeting: (i) The meeting called by requisition of members shall stand dissolved. (ii) In any other case, it shall stand adjourned to the same day next week at the same place and time or on such other day at a place and such other time as may be decided by the Board.	2. If no quorum is present, the meeting shall be adjourned to be called by giving 7 days notice. Shareholders holding 25% of the total share units representing not less than three persons present in person or through proxy shall be the quorum of the adjourned meeting.
3. If at the adjourned meeting, a quorum is not present within half an hour from the time fixed for meeting, the members present shall be the quorum.	

The adjourned meeting can be got adjourned any number of times, if the quorum is not present by the chairperson of the general meeting.

If within half an hour from the time of a meeting a quorum is not present, the meeting will stand dissolved if it was called upon requisition. But in other cases the meeting is automatically adjourned to re-assemble on the same day in the next week. And if at the re-assembled meeting also a quorum is not present within half an hour, as many members as are actually present shall constitute the quorum. The crucial problem in such a case is that. Whether a meeting attended by only one member can be called a meeting at all. This was the question in *Sharp v Dawes*[(1876) 2 QBD 26: 46 LJQB 104: 36 LT 188. An extraordinary general meeting called by the requisitionists was presided over by a person who was not a member and the minimum of two members were not present with him, it was not a valid meeting. *Bhakerpur Simbhaoli Beverages (P) Ltd. v P. R. Pandya, (1995)* 17 Corpt LR 170 P&H. *D.K. Chatterji v Rapti Supertonics (P) Ltd.* (2003) 114 Comp Cas 265 CLB, a resolution passed without the requisite quorum is void *ipso facto*]

There were several shareholders in a company. A meeting was called for the purpose of making a call. Only one shareholder attended the meeting. He, however, held the proxies of other shareholders. He took the chair and passed a resolution for making a call and then proposed and passed avote of thanks. In giving judgment in the Court of Appeal, LORD COLERIDGE said: The word 'meeting' *prima facie* means a coming together of more than one person. This was not a meeting within the meaning of the Act.

On the analogy of this case it may be said that even in the case of a meeting adjourned for want of quorum, the attendance of one member only at the re-assembled meeting may not be enough. Moreover, the section also says that 'the members actually present shall be a quorum'. But exceptions will have to be admitted, particularly in a case like *East v Bennet Bros Ltd.* [(1911) 1 Ch 163: 80 LJ Ch 123: 103 LT826]. Where all the preference shares in a company were held by one shareholder only, it was held that a meeting of preference shareholders attended by him only was proper.

Secondly, Sec. 173 directs that in the case of government companies, one shareholdermay constitute a meeting. This course was adopted in *L. Opera Photographic Ltd. Re* [1989 BCLC 763 Ch D]. In a company consisting of two members with 51:49 holding, the majority shareholder was not able to remove the other from directorship because under the articles a meeting without the other attending was not possible. So the majority applied for a court order that a meeting should be called at which the attendance of one would be the quorum. Since the majority shareholder had a statutory right to remove the other from directorship his right could not be vetoed by quorum requirements and, therefore, the court passed necessary orders. Further, it was held in *Hartley Baird Ltd, Re:* (1954) 3 WLR 964: (1954) 3 AL ER 695: (1955) Ch143]. Where a clause in the articles of a company provided that 'no business shall be transacted at any general meeting, unless a quorum is present when the meeting proceeds to business' that the condition is sufficiently complied with if there is quorum present at the beginning of the meeting when it proceeds to business, and the subsequent departure of a member reducing the meeting below the number required for a quorum does not invalidate the proceedings at the meeting after his departure.

Where the meeting commenced about 1½ hours late because there was no quorum within half hour of the scheduled time, it was held that S. 174 of Indian Companies Act refers only to the presence of the quorum within half an hour and does not talk of the time at which the meeting should be called to order, a delay in the commencement of the meeting did not invalidate it.

Restriction on Voting

Sec. 70 of the Companies Act lays down the cases where a shareholder is not permitted to vote as follows:

(a) In the case of any matter or any transaction or agreement between the shareholder and the company, the concerned shareholder is not entitled to take part or vote atthe meeting in his capacity as a shareholder either himself or personally or through any proxy or representation. But this restriction on voting power of a shareholder is not found either in the English Act or the Indian Act.

(b) The next restriction ins on the voting by a director or his partner or his representation or the matters placed before the meeting which concern with the responsibility of any act done by him or omitted to be done by him or done by him in a wrong manner or any matter concerning his appointment, relieving him from responsibility, dismissal from office, transparency, suspending hi, giving him remuneration, allowance or bonus or increasing or decreasing it or his employment or any agreement contract or in which he has his interest or affiliation.
(c) The shareholder on whom calls have been made in respect of the shares allotted to him and if he has not find the calls, he is not entitled to participate and vote at the meeting.
(d) If any shareholder appoints any director as his representative, such director cannot vote representing such shareholder on any matter the director has any personal interest or in the matter of appointing him.
(e) If a shareholder has taken any loan against the security of the shares in the company from bank or financial institution and as a result of non-repayment of the loan, the Bank or financial institution has instituted legal proceedings and the Bank or financial institution intimate in writing to stop voting by the shareholders, then also such shareholders shall be stopped from voting until the loan is repaid in full.

Excise of Voting Right

If no restriction on voting is placed as above, then the shareholder shall have the right to cast vote at the rate of one vote for one share, unless otherwise prescribed in any provision contained in the Act, or Articles of Association. This rule applies normally for voting on poll. Where no poll is requested or conducted and voting is by show of hands or other methods (other than poll) vote is counted as one vote per person. If any person wants to have the resolution passed by the number of votes one is entitled, he must put a request to the chairman to have a poll for passing the resolution either before voting or during the voting by show of hands or other methods.

Unless restrictions are imposed in the Articles, any shareholder can appoint any person (whether he is a shareholder of the company or not) as his representative / proxy to attend and exercise his vote on his behalf. This section gives proxies right only to attend the meeting and vote on the proposal placed at the meeting.

Voting by Proxy (Sec. 176 of Indian Companies Act)

Where the shareholder is not able to attend in person at any meeting, he can appoint a representative (Proxy) to attend, to take part and vote at the meeting and for that purpose he must send his request with prescribed dorm duly signed by him.

In the case of joint holding of shares, the joint holder authorized by all the joint holders or a representative appointed by such shareholder only will be eligible to take part and vote at the meeting. If no such shareholder has been authorized, then the joint-holder whose name stands first entered in the Register of Members shall be entitled to attend and vote or to appoint a proxy to attend and vote on his behalf and only such proxy form shall be deemed valid.

The instrument appointing a proxy must be in writing and signed by the shareholder, and should be deposited with the company forty-eight hours before the meeting. The Act requires proxy forms to be supplied to members along with the notice for the meeting. The forms should be in blank and should not carry any suggested names. It would be a misuse of privilege to influence voting that way.

A proxy is always revocable. Even where by its terms it is made irrevocable, the law allows the stockholder to remove it. Revocation is, of course, subject to the provisions of the articles. Generally it is provided that revocation must be received at the office of the company before the commencement of the meeting. Accordingly, a revocation was communicated before the poll, but not before the meeting, it was held to be ineffective and the proxy‘s vote stood. Where, however, there is no provision in the articles, the power of revocation would be unfettered. And so in *Narayana Cehttiar v Kaleeswara Mills* [AIR 1952 Mad 515: ILR 1952 Mad 218: (1952) 1 MLJ18.]: A proxy had exercised his votes in the first poll of a meeting but the proxy was revoked before the final poll was held. In the absence of any provision in the articles, the revocation was held to be effective and the rejection of the revocation by the chairman, was, therefore, untenable.

Proxy forms can be inspected by any member who has a right to vote at the meeting or on any resolution to be proposed at the meeting.

Voting in the Case of Election of Directors

A shareholder holding 51 percent of the total voting share units can be sure of electing the whole of the Board or at any rate having a veto over the constitution of the Board. In England and India, there is nothing comparable to the system of ‘Cumulative voting’ which is optional or compulsory in many states of USA and this ‘Cumulative voting’ system has been provided in the Act by Sec. 72 in the case of election of directors. This affords the shareholders the possibility of board representation proportional to their holdings. This is designed to prevent the members being faced with the alternative of either accepting or rejecting the whole of the nominees proposed. That is why, the Indian Act provides that each director should be elected individually. Section 72 provides that the number of votes represented by the shareholding of a member shall be multiplied by the number of director to be elected shall be the available votes for the shareholder and he can elect to cast all the votes in favor of one candidate or split his votes and cast some votes for one person and other votes for another person or distribute his votes among the candidates as he may like. This ensures proportional representation in a manner that a person holding one third of the votes can secure one third representation and a person having 51% could secure only one-half and not more.

In the case of corporate body holding shares in a company, it has two options. Either it can nominate its own directors in proportion to the votes it can exercise or participate in the general voting along with the other shareholders, in case it does not want to nominate any directors or it does not have sufficient proportion of votes to nominate a director. It can however put up candidates for election at the meeting up to the number of director it can nominate in proportion to the number of shares to total shares held by it.

Voting

The business of a meeting is done in the form of resolutions passed at the meeting. Shareholders have the right to discuss every proposed resolution and to move amendments. If an amendment is reasonably germane to a proposed resolution and is not in substance a negative of it, it must be admitted and put to the meeting. Accordingly, in *T. H. Vakil v Bombay Presidency Radio Club:* [AIR 1945 Bom 475. See also *Henderson v Bank of Australasia*, (1890) 45 Ch D 330: (1886-90) All ER Rep Ext.1190]. Where at a meeting of a company the chairman wrongfully ruled an amendment out of order, it was held that the subsequent proceedings relating to that particular motion were invalidated.

After a resolution has been discussed it is put to vote. Every holder of equity shares has the right to vote. The only ground on which the right to vote may be excluded is non-payment of calls by a member or other sums due against a member or where the company has exercised the right of lien on his shares. Persons who are members on the last date for holding the meeting alone would be entitled to vote. Those who became members thereafter by virtue of a Government order were held to be not entitled to vote even at the adjourned meeting.

A provision in the articles of a company introduced by an amendment to the effect that there would be full voting rights in respect of partly paid up shares also was held to be not permissible. It was in violation of the provisions of the Act.

A preference shareholder has the right to vote only on resolutions which directly affect the rights attached to his preference shares.

Exercise of Voting Rights by Shareholders at General Meeting

While the common law rule regarding voting at general meetings is that every shareholder may use his voting rights in his own best interest or as he thought fit 'even though such voting may be detrimental to the interests of the company, it is firmly established rule of law that shareholders having majority voting power cannot use that power for passing any resolution in fraud of the minority shareholders or so as to discriminate between the majority and minority of the shareholders. Any resolution voted for by them should be *bona fide* for the benefit of the company as a whole', the words 'the company as a whole' meaning both the company as a commercial unity and also the corporators as a general body. The majority shareholders cannot use their votes either to defraud the company or gain for themselves or any other person an unfair advantage to the exclusion of the minority shareholders. For a learned discussion on this subject see the judgment of Evershed M.R. in *Greenhalghv.Arderne Cinemas* [(1950) 2 All E.R. page.1120.]

In the recent case of *Clemens v. Clemens Bros. Ltd*. (1976) 2 All E.R. 268, where 55% shareholders attempted to weaken the voting power of 45% holder of shares by passing resolutions for the issue of further shares to herself and her supporters, Foster J., following a dictum of Lord Wilberforce in Re *west-borne Galleries Ltd.* (1972) 2 All E.R. 492 (H.L.) has attempted to give shape to the dictum in the form of a principle as follows:- 'In my judgment the majority shareholders is not entitled as of right to exercise her votes in any way she pleases. To

use the phrase of Lord Wilberforce, the right is subject to equitable considerations which may make it unjust or inequitable to exercise it in a particular way'.

This clearly limits a shareholder's right of voting further than has judicially been recognized so far and awaits confirmation by higher judicial authorities. According to Foster J. the exercise of voting right by a shareholder in a particular way may be restrained if on equitable considerations such exercise is unjust or inequitable.

As regards exercise of voting rights by shareholders, the law as recognized by judicial decisions in U.S.A. is as follows: A shareholder may exercise wide liberality of judgment in the matter of voting, and it is not objectionable that his motive may be for personal profit or determined by whims or caprice, so long as he violates no duty owed to his fellow-shareholders *Hell v. Standard G. & E. Co.* 17 Del. Ch. 214. The ownership of voting stock imposes no legal duty to vote at all. A group of shareholders may without impropriety, vote their respective shares so as to obtain advantages of concerted action. They may lawfully contract with each other to vote in the future in such way as they or a majority of their group from time to time determine 'Ringling Bros. Barmum & Bailey Combined Shows v. Ringling 29 Del. Ch. 610 (1947)'. It is also a condition that the exercise of voting right by a shareholder does not violate any rule of law or public policy.

The point to be noted is that the voting right of a shareholder should not only be opposed to any rule of law or public policy but should also not violate any duty owed to other shareholders.

According to the law of U.K. which is also the law in India, a shareholder owes a duty not only to his fellow shareholders but also to the company and he should not exercise his voting right in such manner as to appropriate either the company's property or the other shareholder's. The expression 'the benefit of the company as a whole' discussed supra, includes not only that the company, but also the interest of the shareholders in the company.

In the case of director-shareholders, as they stand in fiduciary relationship to the company the rule is more exacting than in the case of other shareholders.

Of course the use of voting rights to pass a resolution contrary to public policy will in all cases be invalid, even if passed unanimously.

Proceedings and Decision at General Meeting (Sec.74)

The chairmanship of a general meeting shall ordinarily be undertaken by the chairman of the Board. If there is no chairman, or if the chairman is absent, then the directors present shall nominate one among themselves the chairman for the general meeting and conduct the general meeting. Sec 68 provides that the directors should be present as far as possible at all general meeting. Any director owing to circumstances beyond his/her control, may attend and vote in the general meeting through video conference or other such technology.

All proposals at the meeting shall be in the form of a resolution. Then, voting on that resolution shall be done. The chairman shall declare whether the resolution was passed or not.

On every matter put to vote normally the opinion of the majority vote of shareholders shall be treated as the decision of the meeting. For taking such opinion, the chairman may adopt the following ways: raising the hands, voice vote, division of shareholders or using voting paper or any other appropriate means.

But in the case of special resolutions, if out of the total share units attended at the general meeting, shareholders representing seventy five percent shares out of the total share units present at the general meeting, vote in favor of the resolution, then only the resolution shall be treated as approved by the general meeting.

According to this sub-section, if out of 100 shareholders, only 50 shareholder are present representing 60% of total votes then to pass a special resolution 45% (i.e.75% of 60%) of the total voting rightshare units of the company shall cast their vote in favor of the special resolution, to approve there solution.

If the votes cast in favor of a resolution is equal to the votes cast against the resolution, then the chairperson may cast one decisive vote either way to get the resolution passed or rejected. This is possible only in the case of ordinary resolution and not in the case of special resolution where there cannot be equal vote. Casting vote is a statutory right given to the chairman and it is in addition to his normal rights as a shareholder to vote at the meeting.

Resolutions

Resolutions are of two kinds, namely:

(a) Ordinary resolution, and
(b) Special resolution.

A resolution is said to be ordinary when the votes cast in favor of it at a general meeting of a company exceed the votes, if any, cast against the resolution. In other words, it means a resolution passed by a simple majority of share units present at the general meeting.

A special resolution, on the other hand, requires the support of three-fourth majority of shares units present and entitled to vote at a general meeting. It is also necessary that the intention to propose the resolution as a special resolution should have been specified in the notice calling the general meeting and the notice itself should have been given in accordance with the provisions of the Act. Questions have arisen whether it is necessary for the validity of a special resolution that it should be passed as notified to the members or whether it can be passed with amendments at the meeting. In a case of thiskind: “A notice was circulated of the intention to propose at an extraordinary general meeting a special resolution to cancel the company‘s share premium account on the ground that the amount credited to the account had been lost. It was subsequently realized that the figure standing to the credit of the account also included a small amount arising from a recent issue which was definitely not lost. At the meeting the form of the resolution had to be altered so as to provide not that the account had been cancelled, but that it had been reduced to a certain amount”.

The court did not confirm the resolution as it was not validly passed. The court laid stress upon the requirement of the section, 'intention to propose the resolution as a special resolution', which has been taken to mean that the resolution passed at the meeting must be the same as that specified in the notice. In principle, however, the court agreed that a need for amendment may genuinely arise and the same should be allowed within reasonable limits. Correction of grammatical or clerical errors is allowed. Where the need for an amendment of substantive nature is feared, the notice itself should carry a warning that the resolution shall be passed subject to such amendments as may be determined at the meeting. Thus an amendment of even a slight substance would invalidate there solution.

A typed or printed copy of every special resolution must be registered with the registrar within thirty days of its date.

For a decision relating to almost every important matter affecting the constitution, administration and affairs of a company, the Act has prescribed the formality of a special resolution. The support of a three-fourth majority of shareholders being requisite for passing a special resolution, the requirement is able to take care and protect the interest of a substantial group of shareholders (Sec. 83 of CompaniesAct). Special resolution is required in the following matters under the Act:

1. To alter the memorandum, name and object clause (Sec.21),
2. To alter the articles (Sec.21),
3. To increase or alter the authorized capital (Sec. 21),
4. To alter the rights of the shareholders of any particular class (Sec. 30)
5. To reduce share capital (Sec.57),
6. To merge one company with another (sec.177),
7. To issue bonus shares (sec.179),
8. To purchase its own shares (sec. 61),
9. To keep uncalled capital in reserve to be called only on liquidation [sec. 53(7)],
10. To call the capital kept in reserve as above [sec. 53(8)],
11. To issue shares at a discount (sec. 64),
12. To convert private company into public company and to convert a public company into private company (sec.13 & 14),
13. To liquidate the company [sec.126(3),
14. Ratification of action beyond the powers of the officer but within the powers of the company [sec.103(4) & sec.104(2)],
15. For disposing off more than 70% Assets of the company, [sec.105(1)(a)],
16. For taking loans(excluding short term loans of less than 6 months duration) of more than the paid up capital and free reserves [sec. 105(1)(b)] and
17. To give donations or subscriptions or charity of more than 1% of the average net profits of the past three years or Rs.50,000, whichever is less [sec.105(1)(c)],
18. To pay remuneration not exceeding 3% of the after tax profit to the directors [sec. 91(2)]

Minutes of the General Meeting

Sec. 75 of Companies Act, 2063 requires every company to cause minutes of all proceedings of general meeting to be entered in a separate book kept for that purpose. Such minutes shall be authenticated by the chairperson of the meeting and the secretary of the company signing the

same, if any. In case there is no company secretary, the same should be signed by the chairperson and one representative of shareholders elected by majority opinion of the meeting. The Indian Act provides in the case of chairman is not in a position to sign due to death or illness, then any director duly authorized by the Board shall sign the minutes within thirty days of the meeting. There is no time limit prescribed for preparation of the minutes and signing the same. But, Companies Act, 2063 provides that the minutes shall be sent to all the shareholders within thirty days of general meeting. The minute book is the evidence of the proceedings at the meeting.

Matters to be recorded in the Minutes book of General Meeting

Sec. 75(2) provides that the following matters should be recorded in the Minutes Book:

1. How the notice of the meeting was issued (whether & how sent to member, whether published in the national newspaper as required under Sec.67);
2. How many shareholders were present (an attendance book should be maintained in which each shareholders attending the meeting shall sign and the number of shares represented by them;
3. The number of director/s present through video conference in general meeting if any;
4. The resolutions passed at the meeting;
5. In the case of voting (by poll), the result of voting.

The Minutes book shall be kept at the registered office and shall be available for inspection by any shareholder during office hours. Company Secretary or any person notified for the purpose shall provide the minute book. If the shareholder wants copies of the minutes, the company should provide copies against any charges prescribed for the same.

In India, within thirty days of every such meeting, entries of the proceedings must be made in the books kept for the purpose and their pages must be consecutively numbered. Pasting of loose-leaf papers or maintaining minutes in loose-leaf is not allowed. Proceedings have to be recorded in bound books and, therefore, they have to be handwritten. Typed sheets cannot be pasted. These records are known as minutes.

Each page of a minute book which records proceedings of a board meeting must be signed by the chairperson of the same meeting. In the case of a general meeting, this is the responsibility of the chairman of the same. The minutes of the general meeting is required to be circulated to the shareholder within 30days of the holding the meeting [sec.75 (3)] and also to the OCR within thirty days [Sec.80].

Computerized

Sec. 172 permits that the minutes and other records to be maintained by the company can be kept in electronic machine. But such records shall be kept in a manner that it cannot be altered or are made useless and the matter kept can be easily located and proper arrangements should be made for these and to take copies easily. If they are kept in a non-legible manner, it should be possible to reproduce the same in a legible manner. The date of preparation and any date of any

amendment made also should be clearly recorded. Provision should be made for recording page numbers and signing of each page with the signature of the authorized person.

The minutes of each meeting must contain a fair and correct summary of the proceedings of the meeting. Any error in the minutes of an earlier meeting may be rectified by the Board of Directors. [Gorden Woodroffe Ltd v Trident Investment (1994) 79 Comp Cas 764 CLB]. All appointments of officers made at any such meeting must be included in the minutes.

The chairman may exclude from the minutes, matters which are defamatory, irrelevant or immaterial or which are detrimental to the interests of the company. The discretion of the chairman in respect to the inclusion or exclusion of any such matter is absolute.

Minutes of the board meeting are kept in order that shareholders of the company may know exactly what their directors have been doing, why it was done, and when it was done. If any alteration or addition is called for it should be done by resolution, not by clerical correction.

Minutes kept in accordance with the above provisions are evidence of proceedings recorded in them. Any proceedings of the meeting of which proper minutes have been maintained is presumed to have been duly called and held. Thus in *Edward Keventer Successors (P) Ltd v K. K. Sud, [(1968) 38 Comp Cas507]*, a resolution recorded in the minutes book authorizing the general manager to file a suit was held to be good evidence of his authority. The proceedings at the meeting and the appointments of directors or of liquidators are deemed to be valid. The presumption is however refutable. Where a controversy is raised, evidence of conclusive nature to establish the points stated in the minute would become necessary [*B. Sivaraman v Egmore Benefit Society* (1992) 75 Comp Cas 199 Mad.] The only way to prove that a particular resolution was passed is to produce the minutes book of the company which carries the record of the resolution in question. [*Escorts Ltd v Sai Autos,* (1991) 72 Comp Cas 485 Del]. Anybody challenging the validity of appointment of a director would have to dislodge the presumption of validity arising from recorded minutes, [*C. R. Priyachandra Kumar v Purasawalkam Permanent Fund Ltd.* (1995) 83 Comp Cas 150 Mad.]. Where a chairman was appointed by the court to preside over a meeting because of a conflict between members, it was held that the minutes prepared and approved by him were to be accepted as authentic and not the minutes prepared by the secretary of the company]. At the interlocutory stage, however, the trial court was held to be not justified in expressing doubts upon the genuineness of the minutes. He could not discard them at the stage.

The Act requires the directors to present the audited financial statements, the auditor's report and the Report of the directors to the Annual General Meeting. As stated above, apart from the normal function of the annual general meeting as discussed above, other matters also may be considered at the annual general meeting. Sec. 77(2) provides that any shareholder or shareholders representing 5% of the voting rights of the company may give notice to the company to include any other matter to be discussed at the AGM. Such notice should be given to the company before the company issues the notice calling the meeting. The company should keep ready the financial statements, the Report of the directors and the auditor's report 21 days ahead of the meeting for the purpose of inspection of the same and make arrangements for

delivering copy to the shareholders. Similar provision is repeated in Sec. 79 also. This should be advertised in the daily newspaper of national level. One time advertisement is sufficient. That such documents are kept ready can be included in the notice calling the meeting to be published in the national newspaper. If necessary, the information and documents can be provided electronically also by official website of the Office of Company Registrar. Sec. 172 permits the company to keep records of the meetings, Shareholders register, Index and accounts to be kept in the electronic medium but facilities to be provided to take copies of the same. If any shareholder demands a copy of auditors report, the financial statements and the directors' report, copy of the same should be provided to the shareholder [77(4)].

Unless otherwise provided in the Act, the normal business of an annual general meeting will be deciding on dividend to be paid, appointment of directors and their remuneration, appointment of auditors and their remuneration or any other matters which, according to the Act or the Articles of Association, is required to be approved by the general meeting.

But nowhere the Act provides that the audited accounts should be adopted by the meeting. Similarly Indian Companies Act by Sec. 219 lays down that the copy of every documents to be laid before the general meeting shall be sent to all the shareholders not less than 21 days before the meeting. Sec. 220 says that after the documents are laid down before the meeting, within 30 days of the meeting three copies of the same shall be submitted to Registrar Office. If the Annual General Meeting does not adopt the account or the meeting is adjourned before adopting the accounts, the same should be intimated to the Registrar. Sec. 80 of the Nepal Companies Act also provides that the documents laid before the meeting and the minutes of the meeting should be submitted to the OCR within thirty days of the meeting. It is nowhere provided that the accounts should be adopted by the meeting in full or with reservation.

Now by eliminating statutory meeting & statutory report, Sec. 78 of the Act has provided for similar information to be provided at every annual general meeting by a public company. But the purpose of this annual drill is not made clear. Sec. 78 says that the particulars shall be prepared and submitted to the Office of Company Registrar also at least 21 days before the meeting. The statement should be approved by the Board of Director and certified by the auditor. But this section or Sec.77 does not require this statement to be placed before the Annual General Meeting.

The content of the report as provided in section 78 are as follows:

(a) The total number of the shares allotted,
(b) Number of fully paid up and unpaid shares out of the allotted shares,
(c) Particulars of director, managing director, auditor, chief executive and manager of the company, and amount of remuneration, allowance and facility paid to them,
(d) The names of individuals or corporate bodies subscribing 5 % or more of the paid up capital of the company, and details of shares or debentures held in their names,
(e) The total proceeds of the sale of shares, and particulars of the new shares and debentures issued and raised by the company in the financial year concerned,
(f) The amount due and payable by the director or substantial shareholder or his/her close relative to the company,

(g) The details of payment made or to be made against the sale of shares or for any other matters,
(h) The amount of loans borrowed from banks and financial institutions and principal and interest due and payable,
(i) The amount claimed to be receivable by the company or payable by the company to any other person or details of lawsuits if any, ongoing in this respect,
(j) The number of expatriate (foreign) employees engaged in the management of the company and at other levels, and remuneration, allowances and facilities paid to them,
(k) Where any agreement has been entered into between the company and any foreign body or person on investment, management or technical services or other matter for a period of more than one year, particulars thereof and the particulars of the dividend, commission, fee, charge and royalty, as well paid under such agreement in the financial year concerned,
(l) A statement of the management expenditures of the company in a financial year,
(m) The amount of dividends yet to be claimed by the shareholders,
(n) A declaration that the company has fully observed this Act and the prevailing law,
(o) Other necessary matters.

Sec. 80 provides that a public company shall submit to OCR within thirty days from the date of holding the annual general meeting a return indicating the number of shareholders present in the meeting, number of directors present in AGM through video conference or such technology, a copy of the annual financial statement, director's report and auditor's report and resolution adopted by the meeting. In India, whether AGM is held or not, the audited accounts shall be submitted within one month from the last day on which the AGM is to be held. But there is no such provision in Nepal Companies Act.

Except as otherwise provided in this Act, every company shall submit a copy of the annual financial statement certified by the auditor to the OCR within 6 months of the completion of its financial year.

Extra-ordinary General Meeting

All meetings of shareholders other than the annual general meeting is called special or extra-ordinary general meeting. Such meeting can be called as follows:

By the Board of Directors on their own: For this the Board should pass a resolution calling the meeting and the matters to be discussed;

At the request of the auditor:

(i) by the Board of Directors;
(ii) If not called by the board, the auditor can intimate the ROC, also can call such meeting to discuss any matter that the auditors feels it necessary to call an extra-ordinary general meeting to place certain matter found while doing the audit.

At the request of the shareholders:

(i) Shareholders holding not less than 10% of the Paid-up capital or at least 25% of the total number of shareholdersmay apply at the Office of Company Registrar to call extra-ordinary general meeting giving reasons for the same, then the Board of Directors shall call the

meeting so as to convene the extra-ordinary general meeting of the company within 30 days of such application [Sec. 82(3)];

(ii) If it is not so held, the shareholders may make a complaint to OCR who may call the meeting [Sec. 82(3)].

As a result of inspection or for any other reason if OCR feels a meeting shall be called, then OCR may make the Board of Directors to call the meeting or OCR itself may call the meeting [Sec.82(5)].

Service of Documents on Members [Sec. 53] Indian Companies Act

The mode prescribed by Section 53 for service of documents by a company on its members is that a document may be served either personally or by sending it to him by post. The letter should be sent to his registered address. If he has no registered address, any address, given by him to the company for the purpose of communications may be used. Where post is used as the medium of communications, service shall be deemed to have been effected when aproperly addressed and stamped letter of notice is posted. Where a member wants service by registered post or under certificate of posting and he has paid to the company sufficient amount for the purpose, he must be served in the manner prescribed by him. In either case, the service shall be deemed to have been effected, in the case of notice of a meeting, at the expiration of forty-eight hours from the date of posting, and, in any other case, when such letter is likely to be delivered in the ordinary course of post. Such a presumed service was not deemed to have taken place when the company was not able to produce any record of posting and the addressee denied service.

In the case of a member who has no registered address in India, nor has supplied any address for communication purpose, service shall be taken to have been affected if an advertisement is inserted in a newspaper circulating in the neighborhood of the registered office of the company.

In case of joint-holders, a document may be served on the first named holder. In the case of death or insolvency of a member, the same rules apply for service of documents upon his representatives.

Where certain documents were sent by the company to the shareholders by registered post but the post was not delivered to the addressee, the court said that the company was not absolved from its responsibility of delivering the documents to the shareholders.

Service of Documents on Registrar [Sec. 52] Indian Companies Act

A document may be served on a Registrar by sending it to him at his office by post under a certificate of posting or by registered post, or by delivering it to, or leaving it for him at his office.

Service of Documents on Company [Sec. 51] Indian Companies Act

Documents can be served on a company or its officers by sending them to the registered office of the company by post under certificate of posting or by registered post or by leaving them at the registered office of the company. Where the securities are held in a depository, the records of the

beneficial ownership may be served by such depository on the company by means of electronic mode or by delivery of floppies or discs.

The service of High Court writ by posting it on the company's registered office address was held to be a good service. Service of summons at the company's corporate office has been held to be a good service. There is no compulsory requirement that service in all cases should be at the registered office.

The service of notice on a company, for the purpose of filing a suit, by giving it to the office assistant of the company was held to be not a good service.

Sec. 15 of the Companies Act, 2063 provides for service of notice as follows:

1. Notwithstanding anything contained in current law, in case it becomes necessary to deliver any notice, summons, questionnaire, etc. to any Company or to any Director, shareholder, debenture-holder or employee in relation to matters connected with the business of the Company or the Company itself, it shall be considered to have been duly delivered if it is delivered to the registered office of the Company by hand or sent to the registered office of the Company by registered post or through the telefax, e-mail, telex or other electronic equipment installed in that office. In case any such notice, summons, questionnaire, etc. cannot be delivered in that manner, the concerned Company, Director or employee may be given information thereof by broadcasting or publishing the notice, summons, questionnaire, etc. by radio, television or national dailies. The concerned Company, Director or employee shall be considered to have been informed of the notice, summons, questionnaire, etc. in such circumstances.

2. Notwithstanding anything contained in current law, in case it becomes necessary to deliver any summons, notice, questionnaire, etc. to any Director, shareholder, debenture-holder or employee of a Company on behalf of the Company or on behalf of any competent authority or the Court in relation to matters connected with his official work, it shall be considered to have been delivered if it is sent through his telex, e-mail or telefax address, if any such address has been given by him. Otherwise, it may be sent by registered post to the address given for correspondence. In case the summons, notice, questionnaire, etc. is sent in this manner, it shall be considered to have been duly delivered.

3. Notwithstanding anything contained elsewhere in this Act, in case the Company has to send any notice or information to any of its shareholders, debenture- holders or Directors, or obtain any information from any of them, under this Act, it may act as provided for in its articles of association or send the necessary information to the electronic communication address made available by them by using an electronic communication medium, if they agree to thesame. However, such notices or information must be sent by post or any other reliable medium to any shareholder, debenture-holder or Director who has not agreed to receive such notices or information through an electronic communication medium.

The Indian Act has not recognized the communication through fax or e-mail whereas the Nepal Act, being recently introduced, has recognized the electronic mode of communication, but has

not yet recognized filing information or data through electronic medium to ROC., whereas now in India by an amendment it has been made compulsory to file all returns, the list of shareholdings etc. through e-filing or through CD/Floppy.

12 DIRECTORS

"A corporation is an artificial being, invisible, intangible and existing only in contemplation of law". [MARSHALL J in *Trustees of Dartmouth College v Woodward,* (1919) 17 US 518, 636, citedin Laski, *The Personality of Association,* 29 Har LR404]. "It has neither a mind nor a body of its own". [HALDANE LC in *Lenanard's Carrying Co. v Asiatic Petroleum Co.* 1915 AC 705 at p 713: (1914-15) All ER Re 280:113 LT 195]. "A living person has a mind which can have knowledge or intention and he has hands to carry out his intention. A corporation has none of these, it must act through living persons". [*Tesco Supermarkets Ltd v Nattrass,* 1977 AC 153 at p 170, *per* Lord REID] This makes it necessary that the company's business should be entrusted to some human agents. Hence, the necessity of directors. Section 86 of the Act, therefore, requires that 'every public company shall have at least 3 directors and maximum 11 directors whereas, every private company shall have such number of directors as provided in theArticle not exceeding 11'.

Although the Act requires all companies except private companies to have directors, it leaves the determination of their functions very largely to the Company's constitution. In case of private companies including the single shareholder company, whether the company constitutes the BoD or not shall be expressly mentioned in its AoA. If it provides for the formation of BoD, then number of directors shall not be more than 11.

Function of Directors

Functions of Directors relate to two main areas of corporate life that is production of an annual financial statements and the controllingadministration of the company and in particular to communicate to the company regulating authorities. Thus, the directors are under a duty to prepare each year's a balance sheet and Profit & Loss Account and a Directors Report if required, to approve them and to send copies to the OCR and to lay them before the annual general meeting.

In many cases, the obligation is laid not only on the directors but upon any 'offices of the company' and the punishment for non-compliance is laid on any 'officer who is in default'.

(a) Function of Companies Articles

The allocation of decision making over the Company's business policy is largely a matter for the Articles of Association. But sometimes in the case of listed public company, the listing rules will make inroads into the powers of the directors by stipulating that shareholder approval must be obtained for decisions which are likely to have a major impact that are defined as those exceeding more than 70% of any undertakingone of a number of financial measures of significance for example, assets, turnover, profits or market capitalization. (Sec.105)

The directors appear to obtaining their powers by way of delegation from the shareholders rather than independently of the shareholders and by means of the provisions of the Act. However, this does not make the directors the agents of the shareholders, but it does produce, as between the directors and the company, a relationship akin to agency. This is because decisions of the majority of the members of the company in general meeting are regarded as the acts of the company. By adopting appropriate provisions as to the authority of the board, the shareholders thus act as the company so as to delegate authority to the directors, which authority they can subsequently restrict. Delegation is normally not to individual directors but to the directors as a board, but the articles normally permit further delegation by the board to individual directors or to committees of the board.

Until the end of the nineteenth century, it seems to have been generally assumed that the principle remained intact that the general meeting was the supreme organ of the company and that the board of directors was merely an agent of the company subject to the control of the company in general meeting. *Thus, in Isle of Wight Railway v Tahourdin,* the court refused the directors of a statutory company an injunction to restrain the holding of a general meeting, one purpose of which was to appoint a committee to reorganize the management of the company. Cotton L. J.said: "It is a very strong thing indeed to prevent shareholders from holding a meeting of the company when such a meeting is the only way in which they can interfere if the majority of them think that the course taken by the directors, in a matter *intra vires* of the directors, is not for the benefit of the company".

In 1906, however the Court of Appeal in *Automatic Self-Cleansing Filter Syndicate Co. v Cuninghame,* [(1906) 2 Ch. 34, CA] made it clear that the division of powers between the board and the company in general meeting depended in the case of registered companies entirely on the construction of the articles of association and that, where powers had been vested in the board, the general meeting could not interfere with their exercise. The articles were held to constitute a contract by which the members had agreed that the directors and the directors alone shall manage [*Per* Cozens-Hardy L.J. at 44]. Hence the directors were entitled to refuse to carry out a sale agreement adopted by ordinary resolution in general meeting.

The new approach, though cited with apparent approval by a differently constituted Court of Appeal in 1908, did not secure immediate acceptance but since *Quin & Axtens v Salmon* [(1909) 1 Ch. 311, CA; (1909) A. C. 442, HL] it appears to have been generally accepted that where the relevant articles are in the normal form exemplified by successive Tables. A, the general meeting cannot interfere with a decision of the directors unless they are acting contrary to the provisions of the Act or the articles.

In *Scott* v Scott [(1943) 1 All E.R. 582. it was held that resolutions of a general meeting, which might be interpreted either as directions to pay an interim dividend or as instructions to make loans, were nullities. In either event the relevant powers had been delegated to the directors, and until those powers were taken away by an amendment of the articles the members in general meeting could not interfere with their exercise. As Lord Clauson rightly said, the professional view as to the control of the company in general meeting over the actions of directors has, over a period of years, undoubtedly varied.

(b) Default Powers of the General Meeting

It seems that if for some reason the board cannot or will not exercise the powers vested in them, the general meeting may do so. On this ground, action by the general meeting has been held effective where there was a deadlock on the board; where there were no directors; where an effective quorum could not be obtained or the directors were disqualified from voting. Moreover, although the general meeting cannot normally abort legal proceedings commenced by the board in the name of the company, it still seems to be the law that the general meeting can, in some circumstances, commence proceedings or ratify unauthorized proceedings already commenced by someone on behalf of the company if the directors fail to pursue the claim. These exceptions are convenient, but difficult to reconcile in principle with the strict theory of a division of powers. Their exact limits are not entirely clear.

If the directors have purported to exercise powers reserved to the company in general meeting their action can be effectively ratified by the company in general meeting. And for the purpose of ratifying past actions of the board, as opposed to conferring powers on the board for the future, it is not necessary to pass a special resolution altering the article; normally an ordinary resolution will suffice. But Sec.103 requires special resolution in such a case also.

(c) Unanimous Consent of the Shareholders

The shareholders have power to act, despite provisions in the articles apparently conferring exclusive authority on the directors. They allow the shareholders to take, or participate in the taking, of a corporate decision if the board is unable to exercise its powers, if the board‘s decision is in some way defective or, perhaps, if they are invited by the board to participate in the decision. It is also established in case law that the shareholders may bind the company by unanimous agreement. ‘Unanimous’ here meaning all the shareholders entitled to vote, not just all those who turn up at a meeting. The main function of this rule is to permit shareholders in small companies to take the decisions allocated to them without the need to hold a meeting (for example, by circulating a resolution, to which they individually indicate their consent) or without observing all the formalities (for example, as to notice) which shareholder meetings entail. However, there are also dicta in the cases which suggest that the unanimous consent of the shareholders binds the company, even on matters which the constitution allocates to the board.

The nearest case is *Re Empress Engineering Works Ltd*, [(1920) 1 Ch. 466, CA] where the decision in question was the purchase of certain property and thus would clearly have fallen within the clause conferring general management powers on the board, but in fact all the directors were disqualified from acting on the purchase, and so the shareholders could be said to have had default powers to take this decision. As to the merits of allowing the shareholders unanimously to depart from the constitution, the requirement of unanimity means that there is no issue of the protection of minority shareholders, which was one of the factors which weighed with the courts when they introduced the doctrine that shareholders, by ordinary resolution, could not give directors instructions on matters within their competence. On the other hand, allowing unanimous shareholder consent to override the articles would emphasis the primacy of shareholders as against the directors. Shareholders would be able to tell the directors what to do,

even within the area of competence granted by the articles to the board, provided only they acted unanimously.

Sec. 187 of the Act makes a provision for such agreement between shareholders as follows:

(1) Every agreement signed among the shareholders of a Company on issues concerning the management and operation of the Company and exercise of the shareholders' voting rights shall be binding onthem. However, in case any provision of any such agreement is opposed to the interests of the Company or those of its minority shareholders, it shall be inoperative ipso facto to that extent.
(2) The concerned shareholder shall submit two copies of the agreement entered into under sub-section (1) above to the company within 15 days after the date on which such agreement was entered into. The company shall submit a copy of the agreement so received from the shareholders to the ROC within fifteen days after the receipt of the same.

This sort of agreement is made when a public company is incorporated by the joint efforts of different business groups who want to define their rights and obligations towards the company, regarding appointment of directors, managing director, chairman of the Board and the proportion of shares to be maintained among them etc.

Position of Directors

The position that the directors occupy in a corporate enterprise is not easy to explain. They are professional person hired by the company to direct its affairs. Yet they are not the servants of the company. They are rather the officers of the company. 'A director is not a servant of any master. He cannot be described as a servant of the company or of anyone'. 'A director is in fact a director or controller of the company's affairs. He is not a servant. A director may, however, work as an employee in a different capacity'.

In the words of BOWEN LJ [*In Imperial Hydropathic Hotel Co v Hampson*, (1882) 23 Ch D 1: 49 LT150]: Directors are described sometimes as agents, sometimes as trustees and sometimes as managing partners. But each of these expressions is used not at exhaustive of their powers and responsibilities, but as indicating useful points of view from which they may for the moment and for the particular purpose be considered.

According to JESSEL MR: "Directors have sometimes been called trustees, or commercial trustees, andsometimes they have been called managing partners, it does not matter what you call them so long as you understand what their true position is, which is that they are really commercial men managing a trading concern for the benefit of themselves and of all other shareholders in it".

Directors as Agents

It was clearly recognized as early as 1866 in *Ferguson v Wilson*, [(1866) 2 Ch App 77: 36 LJ Ch 67: 15 LT 230] that directors are in the eyes of law, agents of the company. The Court said: The company has no person; it can act only through directors and the case is, as regards those directors, merely the ordinary case of principal and agent.

The general principles of agency, therefore, govern the relations of directors with the company and of persons dealing with the company through its directors. Where the directors contract in the name, and on behalf of the company, it is the company which is liable on it and not the directors. Thus where the plaintiff supplied certain goods to a company through its chairman, who promised to issue him a debenture for the price, but never did so and the company went into liquidation, he was held not liable to the plaintiff. Similarly, where the directors allotted certain shares to the plaintiff, they were held not liable when the company, having exhausted its shares, failed to give effect to the allotment. Just as notice to an agent in the course of business amounts to notice to the principal so it is true of directors in relation to the company. But notice to a director will amount to notice to the company only if the director is, like an agent, bound in the course of his duty to receive the notice and to communicate it to the company. It was held in *Hampshire Land Co, Re,* [(1896)2 Ch 743] that where one person is an officer of two companies, his personal knowledge is not necessarily the knowledge of both the companies unless he is under a duty to receive the notice and to communicate it to the other. Like agents, they have to disclose their personal interest, if any, in any transaction of the company. It should, however, be remembered that they are the agents of an institution and not of its individual members.

Directors to be Held Responsible if the Net Worth of the Company Declines (Sec. 60)

(1) In case the net worth of a public Company declines and becomes half or less than half of its paid-up capital, the Directors must formulate appropriate strategies for serving the interests of the Company and its shareholders within 35 days from the date when they learn about the same. A separate resolution related to the matter must be presented at the general meeting to be held subsequent to learning about thematter. However, an extraordinary general meeting must be convened as soon as possible in case it becomes necessary to secure the approval of the general meeting to implement those strategies.

(2) The Directors of a Company who do not formulate the strategies, present the concerned resolution before the annual general meeting, or convene an extraordinary general meeting as mentioned in Sub-Section (1), or who deliberately maintain the situation of not convening any such meeting, shall be punished under this Act.

(3) In case it is found that the net worth of a Company has declined as mentioned in Sub-Section (1) due to the *mala fide* motives or malicious negligence of a Director, the Director shall also be required to pay compensation therefore.

Directors as Trustees

On the position of directors as trustees, the Nigerian Act contains this provision: "Directors are trustees of the company' smoney, properties and their powers and as such must account for all the moneys over which they exercise control and shall refund any moneys improperly paid away, and shall exercise their powers honestly in the interest of the company and all the shareholders, and not their own sectional interests".

Although directors are not properly speaking trustees, yet they have always been considered and treated as trustees of money which comes to their hands or which is actually under their control; and ever since joint stock companies were invented directors have been held liable to make good moneys which they have misapplied upon the same footing as if they were trustees. In *Ramaswamy*

Iyer v Brahmayya & Co, [(1966) 1 Comp LJ 107] the Madras High Court observedthat: The directors of a company are trustees for the company, and with reference to their power of applying funds of the company and for misuse of the power they could be rendered liable as trustees and on their death, the cause of action survives against their legal representatives.

Another reason why directors have been described as trustees is the peculiar nature of their office. For example, they, like trustees, occupy a fiduciary position. Moreover, almost all the powers of directors are powers in trust. The power to make calls, to forfeit shares, to issue further capital, the general powers of management and the power to accept or refuse a transfer of shares, are all powers in trust which have to be exercised in good faith for the benefit of the company as a whole.

For whom trustees?

Directors are trustees of the company and not of individual shareholders. This principle was laid down in 1902 in *Percival v Wright,* and still holds ground as a basic proposition. In that case: Negotiations for the sale of a company's undertaking were on foot and without disclosing this, the directors purchased shares from the plaintiff-shareholders. The selling shareholders had written to the company's secretary asking him if he knew anyone willing to purchase their shares. Three directors offered to buy the shares at a price assessed by an independent valuer but they did not disclose that they were in the process of negotiating the sale of the company at a price per share considerably higher than the amount offered to the shareholders. The negotiations proved to be abortive, but the plaintiffs claimed that the non-disclosure was a breach of the fiduciary duty entitling them to repudiate the sale.

But the court held that there was no such fiduciary duty towards individual shareholders and, the directors were not bound to disclose negotiations which ultimately proved abortive. The court also pointed out that a premature disclosure of this kind might well be against the best interests of the company.

The principle of the case was reiterated in *Peskin v Anderson*. Ordinarily the directors are not agents or trustees of members or shareholders and owe no fiduciary duties to them.

This decision remained unchallenged in common law jurisdictions until the New Zealand decision in *Coleman v Myers*. The case involved a struggle for control of a privately held family company. The company had substantial assets, like cash reserves, valuable lands and buildings. The assets were undervalued in the books of account. They showed the share value to be at $4.10 on a going concern basis. If accounts were taken of the true asset backing of the shares, they were worth $7.75. The dominant majority shareholder formed another company which made a takeover offer at $4.80 per share. The reluctant minority shareholders were given notices of compulsory acquisition of shares. They eventually agreed. They had no access to inside information on the true value of the assets. No information was given to them. When they discovered the true facts they sought setting aside of the sale because of the breach of fiduciary duty.

MAHON J, said that the case could not be distinguished from *Percival v Wright* but that, in fact, *Percival v Wright* was incorrectly decided and, in the circumstances of the two cases, where directors were buying shares in their own company, a fiduciary duty was owed to shareholders. The Court of Appeal were, however, content to distinguish *Percival v Wright* on the special facts of the case. It held that the court will not impose a fiduciary duty automatically upon directors when they enter into transactions with the company's shareholders. Because of the special circumstances of this case, the court did impose a fiduciary duty. The circumstances were: Face-to-face negotiations in which the members relied upon the directors to disclose all material information; the directors had a high degree of inside knowledge; and the directors actively promoted the scheme and advised the shareholders to accept.

The decision in *Percival v Wright* left scope for the rule that when negotiations reach a certain stage of maturity a disclosure of the director's profits to the selling shareholders would be necessary, otherwise the directors would be failing in their fiduciary obligation towards them. The principle found application in *Allen v Hyatt.* [(1914) 30 TLR 444.] A decision of the Privy Council on appeal from Ontario]: The directors of a company represented to the shareholders that their consent was necessary in order to effect an amalgamation and induced the shareholders to give them the option to purchase their shares. They exercised the option, carried out the amalgamation and made a profit. It was held that the directors were trustees of this profit for the benefit of the shareholders. They cannot always act under the impression that they owe no duty to individual shareholders. Now, of course, there is a statutory obligation to disclose a profit of this kind to the shareholders along with the offer by which their shares are proposed to be acquired.

In situations like this where the directors act as agents for the shareholders, the latter would be liable to the purchasers of their shares for any fraudulent misrepresentation made by the directors in the course of negotiations.

Trustees of institution

The role of the corporation in the modern society is something different from what it was in the previous century. "The modern company should function not simply as an economic machine designed to churn out profits for its shareholders, but rather as an institution which owes social responsibilities to a wide circle of interests". The Supreme Court has already conferred its recognition upon the 'social character' of a company. In Charanjit Lal v Union of India, [1950 SCR 869L: AIR 1951 SC 41 at p 59(1951) 21 Comp Cas 33] MUKHERJEE J observed: "A corporation which is engaged in the production of a commodity vitally essential to the community, has a social character of its own and it must not be regarded as the concern primarily or only of those who invest money in it". Accordingly, the directors become 'the administration of a community system'. Public responsibility of a company means to take account of outside interests affected by corporate operations. To the extent the directors are bound to consult outside interests, they become the trustees of such interests.

Directors as Organs of Corporate Body

"There was a time when corporations played a very minor part in our business affairs, but now they play the chief part, and most men are the servants of corporations". "There is scarcely any business pursued requiring the expenditure of large capital, or the union of large numbers that is not carried on by corporations. It is not too much to say that the wealth and business of the country are to a great extent controlled by them".

This transformation has been brought under the influence of the organic theory of corporate life, "a theory which treats certain officials as organs of the company, for whose action the company is to be held liable just as a natural person is for the action of his limbs". Thus "the modern directors are something more than mere agents or trustees. The board is also correctly recognized to be a primary organ of the company". As NEVILLE J put it in Bath v Standard Land Co: [(1910) 2 Ch 408, 416].

The Board of Directors is the brain and the only brain of the company, which is the body and the company can and does act only throughthem. "When the brain functions the corporation is said to function". Similarly, GREEER LJ said in Fanton v Denville [(1932) 2 KB 309 at p 329] that "a general manager of the business is regarded as the alter ego of the company, and it would be responsible for his personal negligence". Likewise, a company was held liable for giving a false warranty without having reason to believe that it was true. The decision of the House of Lords in Lennard's Carrying *Co v Asiatic Petroleum Co* [1915 AC 705: (1914-15) All ER Re 280: 113 LT 195] gave a further fillip to this development:

The facts were that the Merchant Shipping Act of 1874 provided that a ship owner would not be liable to make good a loss of or damage to the goods happening without 'his actual fault'. The ship owner in this case was an incorporated company and the loss had taken place due to the negligence of a managing director. The company was sued for the loss and its chief defence was that the company, being an artificial person, was incapable of committing 'actual fault'.

Rejecting this contention, LORD HALDANE in his well-known passage said [*Id*. At pp 713-714. Reaffirmed by the House of Lords in Tesco Supermarkets Ltd v Nattrass, (1971) 2 WLR 1166:(1971)2AllER127: 1972AC153]–Acorporationisanabstraction.Ithasnomindofits own any more than it has a body of its own; its acting and directing will must, consequently, be sought in the person of somebody who for some purpose may be called an agent, but who is really the directing mind and the will of the corporation. That person may be under the direction of shareholders in general meeting; that person may be the board of directors itself. (His) fault is the fault of somebody who is not merely a servant or agent for whose action the company is liable upon the footing *respondent superior*, but somebody for whom the company is liable because his action is the very action of the company itself.

The company's intention to occupy a premise for its own business requisite under the Tenancy Acts to evict a tenant, can be known by referring to the directors' conduct irrespective of any formalities. DENNING LJ explained the organic character of the company's life in the following words: "A company may in many ways be likened to a human body. It has a brain and a nerve center which controls what it does. It has also hands which hold the tools and act in accordance

with directions from the center. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work, and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind or will of the company and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such".

But the courts have not attempted to define the persons whose acts or intentions are to be considered the acts or intentions of the company. It has, however, been suggested that it would include the company's governing body, directors, managing director or general manager or other persons having authority from the board of directors to conduct the company's business. For certain purposes even the secretary has been recognized as an essential organ. For example, in *Panorama Development (Guildford) v Fidelis Furnishing Fabrics*, [(1971) 3 WLR 440] a company was held liable for the hire of taxis engaged by the secretary for his personal purposes while operating from the office of the company. Commenting upon the growing importance of the secretary, LORD DENNING MR said: "A modern secretary is not a mere clerk of an officer of the company with extensive duties and responsibilities and has authority to sign contracts connected with the administrative side of a company's affairs and has ostensible authority to enter into a wide range of contracts. In that respect his position has altered very materially since the 19th century".

Personal Liability of Working Organ

When a tort or some other wrong happens to occur in the working processes of a company, the question would be whether the responsibility for it is to be attributed to the company or it should be borne by the director alone. The applicable principle has been thus stated: "The authorities clearly show that a director of a company is not automatically to be identified with his company for the purpose of the law of tort, however small the company may be and however powerful his control over its affairs. Commercial enterprise and adventure is not to be discouraged by subjecting a director to such onerous potential liabilities. In every case where it is sought to make him liable for his company's torts, it is necessary to examine with care what part he played personally in regard to the act or acts complained of". [Per SLADE LJ in C. *Evans & Sons Ltd v Spritbrand Ltd, (1985)* BCLC 105 at p110]

In a *New Zealand* case [*Trevor Ivory v Anderson,* (1992) 2 NZ LR 517] the director of a one-man company gave advice, through the company, to a client for spraying of an insecticide around fruit trees. The advice was so negligent that fruit trees perished along with their parasites. The court did not consider the circumstances to be such as to hoist personal liability on the director. He had made it clear that he was trading through the company and the company was the legal contracting party to be charged with liability. As compared with this, in *Fairline Shipping Corpn v Adamson* [(1974) 2 All ER 967: (1975) QB 180] the director became personally liable for loss of perishable goods from the storage provided by his one man company. The liability hinged on a letter written by the managing director to the plaintiffs on his own note paper rather than that of the company, an act which the court thought displayed an assumption of personal duty of care. In *Williams v Natural Life Health Foods Ltd,* [(1997) 1 BCLC 131] a health food shop was established under a franchise agreement. The franchiser company provided income projections estimates from the shop on which the plaintiff company relied in accepting the

franchise. These projections proved inaccurate and after 18 months the plaintiff's business closed with substantial losses. The franchiser company came to be wound up. The plaintiffs sued the promoter-director of the company who had provided the estimate. The Court of Appeal held that in this case the director had acted in a capacity outside that of a mere director and had assumed a personal responsibility to the plaintiffs which was additional to that of the company.

Liability for Bouncing of Cheques

The company would be liable to be prosecuted for the bouncing of a cheque if it was issued under the authority of the company. A complaint which alleged that the cheque was issued by a director who was in charge of and responsible for the day to day administration of the affairs of the company, was not liable to be quashed. [*Unico Trading and Chit Funds(India) (P) Ltd v Zahoor Hasan, (1991) 71 Comp Cas 270* Kant; *Voltas Ltd v Hiralal Agarwalla*, (1991) 71 Com. Cas 273 Cal. The prosecution is under S. 138 of the Negotiable Instruments Act,1881]

Powers & Duties of Directors

Sec. 95 of the Companies Act defines the Powers & Duties of the Directors. Subject to the Act and Articles of Association and the decisions of the general meeting, the directors, through the Board of Directors is a collective body, shall carry out the power and duties of management of all the affairs of the company. No directors of a public company shall derive any personal benefit / profit from the company in which he is a director except as permitted by the decision of the general meeting. But the private company can make reasonable provisions in its Memorandum & Articles of Association or as provided in the unanimous agreement for benefit to the directors from the company.

Unless provision to the contrary is made by the Act, Memorandum & Articles of Association of the company or by the unanimous agreement in the case of a private company, the Board of Director can appoint any director among themselves or any employee of the company as its representative severally or jointly to carry out any work, to correspond, to sign the cheque and bills of exchange on behalf of the company or by delegating some powers. While delegation such powers, the decision of the Board delegating such powers should be authenticated at least by one director and the company secretary, if one is there. Any loss caused to the company by any action does by any person as a director or such representative on behalf of the company, can be called to be compensated by the company.

The effect of this section is that subject to the restrictions contained in the Act, and in the memorandum and articles of the company, the powers of directors are co-extensive with those of the company itself. Once elected and in control, the directors have almost total power over the operations of the company, until they are removed. The share market crash highlighted the problem inherent in director's autonomy over all company affairs. There is no restriction on the appointment of directors. There are, however, two important limitations upon their powers. Firstly, the board is not competent to do what the Act, memorandum and articles require to be done by the shareholders in general meeting and, secondly, in the exercise of their powers the directors are subject to the provisions of the Act, memorandum and articles and other regulations

not inconsistent therewith, made by the company in general meeting. 'Individual directors have such powers only as are vested in them by the memorandum and articles'.

Section 95(6) of the Act puts a limitation that certain powers can be exercised only at a meeting of the Board of Directors validly called and constituted. In other words, these powers cannot be delegated to any director or officer of the company and also that these powers cannot be exercised by circulation of the minutes. These powers are:

(i) To make a call of unpaid balance amount from the shareholders;
(ii) To issue debentures;
(iii) To exercise the power to raise loans and take advances other than debentures;
(iv) To invest the funds of the company;
(v) To make loans.

But the section has made an exception in the case of banking and financial companies for making loans and to take deposits in the course of their regular transaction.

The Indian Act Sec. 292 makes a more detailed provision with regard to delegation of the powers (iii) to (v) mentioned above to any sub-committee of the Board, the managing director or other officers subject to the limitations mentioned in that section.

In the case of item (iii) the resolution delegating the power should mention the maximum amount that maybe outstanding at any one time, up to which moneys may be borrowed by the delegates.

In the case of item (iv), the resolution shall maintain the maximum amount that can be invested and the nature of investment that may be made by the delegates.

In the case of item (v), above the resolution shall mention the total amount up to which loans may be made by the delegates, the purpose for which the loan is to be made and the maximum amount of loan which may be given for each purpose.

Even though these are not mentioned in the Act, these may be presumed as the best practice to be followed.

Restriction on the Powers of the Company and the Board of Director

Under Sec. 101 of the Act, no company is permitted to give loans or financial assistance to any officer, substantial shareholders or officer, substantial shareholder of a holding company or subsidiary company or a close relative of such person. Similarly, the company cannot extend guarantee or provide security in respect of any loan taken from other institution or person by any of the above person.

But this does not prevent any loan or other facility being given to employees in accordance with company's rules or does not apply to the giving of loans or giving guarantee in the normal course of business of the company, as a bank or financial institution. Any loan given before the

Act coming into force, should be repaid within Aswin 22, 2065. The above restrictions apply to all companies.

Section 105 puts another restriction on any public company and on private companies which have taken loans from banks or financial institution in the case of following transaction that they will require special resolution of the General Meeting of the shareholders:

(a) If it proposed to dispose of the rights in more than 70% of one or more undertakings managed by the company by sale, gift or on lease or by any other means.
(b) To borrow money more than the amount of its paid-up capital and the accumulated profit or free reserves. But this does not apply for short term loans from bank or financial institutions for a period of less than 6 months. But this does not apply to banking companies and financial institution taking deposits from the public or for insurance premium received by insurance companies. This should not apply to only life insurance companies.
(c) To donate in any financial year by way of gift, donation or grant more than Rs.100,000/- or one percent of the average net profit of the past three years whichever is less. But this restriction does not apply to expenditure by way of grant, donation or assistance to the company‘s employee or for the promotion of the company‘s business.

But it has made an exception to this restriction in case of real estate companies and other companies who do the only business of purchase and sale of fixed assets and movable assets like shares & securities. The General Meeting can prescribe any suitable terms and conditions while granting approval.

Register of Directors

Every company should keep a register of directors and if there is a company secretary (in the case of public companies) should keep a register of company secretary.

In the register maintained as above every company should enter the following particulars.

Register of Director	Register of Secretary
1. Name of Director	Name of Secretary
2. Surname	Surname
3. Address	Address
4. Nationality	Nationality
5. Profession or business	Profession or business
6. Date of appointment	Date of appointment
7. Date of removal	Date of removal.

If there is any change in the above particulars, the same should be notified to ROC within 15 days from the date of change.

Notice by Directors and Transaction by Director with the Company

Under Sec. 92 within 15 days of being appointed to the office of director of a company, the director has to give a written notice to the company on the following matters:

(a) Direct involvement of himself or his near relative or any personal interest in any purchase or sale or any other kind of contract relating to the company‘s transactions;

(b) If there is any kind of sale of interest in the appointment of managing director or company secretary or any other officer of the company;
(c) If he is a director of any other company or debentures;
(d) If he has done any trade in the shares of the company or shares of its holding or subsidiary company, then matters connected with the same.

For the purpose of this section 'Direct involvement' has been defined to mean himself or his near relative being the promoter of the company or any private firm or company or partnership firm or director in a company involved in similar transaction.

While notifying as above, if there is any written agreement between the company and the director or the near relative, then a copy of such agreement also should be submitted. If there is no such written agreement, then important and necessary matters relating to such transaction on self-interest or involvement should be provided.

Within 7 days of receiving the above information, the same should be forwarded to OCRand upon receipt of such information, the Office shall record the same in a separate register maintained for this purpose.

If any director comes to know there being any self-interest or any self-interest coming into existence directly or indirectly in any contract or lease or transaction or any agreement entered into or to be entered into with the company or its subsidiary, then he should intimate the extent of his interest and the nature of the same to the company as soon as possible. It may be noted that there is no time limit prescribed.

If he gives a notice that any transaction with a specified person be treated as involving his self-interest, then he shall be deemed to have given notice of his self interest in any transaction or contracts entered into with such specified person.

Sec. 93 provides further that no public company shall, without approval of the general meeting, do any significant transaction with its director or his/her close relative or substantial shareholder ***or any firm, company or other corporate body having owned substantial share by such director or his/her close relative or substantial shareholder,*** or no subsidiary company shall, without approval of the general meeting of its holding company, do any significant transaction with any director or his/her close relative or substantial shareholder of the holding company.

Similarly, the director or his close relative or substantial shareholder of a holding company cannot enter into any substantial transaction with the subsidiary of a holding company without the approval of the General Meeting of the holding company.

'Substantial transaction' has been defined to indicate any transaction involving the purchase of any service or goods, sale, lending & borrowing civil contract of the value of more than - Rs. One lakh at the time of transaction or 5% of the total assets of the company whichever is less. This will also include the transaction of taking on rent or lease involving Rs.1,20,000 or more per annum".

If any transaction takes place without approval of the General Meeting, any amount or gain received directly or indirectly should be returned to the company and if any loss or deficiency is caused to the company by such transaction, the person taking part in the gain of the transaction should compensate the company for the same. [(Sec. 93(2)]

But an exception is made in Sec. 93(3) for the receipt of goods in the following circumstances i.e, no approval of general meeting is required:

(a) In case the holding company receives property from a wholly owned subsidiary;
(b) In case a wholly subsidiary of a holding company receives property from another wholly owned subsidiary company of the holding company;
(c) In the case of regular business transaction of the company, the transaction done at the prevalent market price.

Sec. 94 provides another obligation on the director of a company. If any person, while occupying the position of director in a company, acquires any rights to any shares or debentures in that company or its subsidiary company or its holding company or any other subsidiary of the holding company, he should give the company the following information:

(a) Particulars of his rights and interests;
(b) Amount of any class of debentures and the number of every class of shares of the concerned company or any other company in which he has the rights and interest while holding the office of the director.

But no time limit is given for submitting the information. But if he does not submit the particulars he will be liable for punishment Sec.162.

The director of a company should inform the company in which he is a director within 15 days of coming to know of the following circumstances a rising:

(a) If for any reason, any of his rights or interest in any shares or debentures of the company in which he is a director or its subsidiary or of holding company or if any other subsidiary of such holding company is being acquired or disposed of or has ceased to exist;
(b) If he enters into any agreement to sell any of the shares or debentures as statedabove;
(c) If he transfers to others his right to subscribe to the shares or debentures of the company of which he is a director;
(d) If the subsidiary or holding company or any other subsidiary of such holding company offers the right to subscribe their shares or debentures;
(e) If he transfers the right to subscribe the shares or debentures as above to anybody.

While giving information as above, he shall give details of the total number of shares or debentures, their amount and class.

This provision regarding the acquisition & disposal of shares apply also to the close relatives of the directors. Sec. 2(ai) defines the close relatives. All those provisions apply to nominee directors as well as alternate directors. But this will apply also to independent director, if he or his near relative acquires or dispose of rights to any shares or debentures issued by the subsidiary company or holding company or any other subsidiary of the holding company. The independent

director cannot hold shares in the company in which he is a director; but Sec. 89(2) has not put any disqualification to holding shares in subsidiary/holding company or any other subsidiary of holding company by an independent director.

Substantial Shareholders (Sec. 50)

Substantial shareholders of a company also stand in the same position of director of a company for disclosing the information to the company of his name and address as well as full particulars of the shares registered in his or his agent's name, within thirty days of coming to know that he is a substantial shareholder. Similarly, if he ceases to be a substantial shareholder by disposing off his shares in full or partly, he shall give the information to the company setting out his name and address as well as full particulars of the shares disposed of as well as the reason why he has ceased to be a substantial shareholder, within thirty days of coming to know that he has ceased to be a substantial shareholder.

Substantial shareholder has been defined in the section as follows:

(a) A person holding ordinary shares with full voting rights that are five percent or more of the total voting rights of the company in his name or in his agent's name;
(b) A person holding one percent or more of the paid up shares of a company whose total paid up capital is more than Rs. 250 million or Rs.25 Crores.

Managing Director (Sec. 96)

Subject to the Articles of Association, the directors may appoint one among them as the managing director. This means that at first, the Articles of Association should contain the provision for appointment of Managing Director. If the Articles does not provide for a managing director, no managing director could be appointed unless the Article is amended by a special resolution. Further the section allows for one managing director only. So there cannot be joint managing director as in India and UK. It may be necessary to have two managing directors depending on the volume and nature of the business of the company. But other additional full time executive directors can be appointed. But they work as executives but not as director.

The duties, responsibilities and powers of the Managing Director shall be as provided in the Articles or as decided by the Board of Director. Here this will have to be passed at the Board meeting. While appointing the managing director or any other director for taking responsibility of the management of the company, there should be a written agreement between the company and the concerned director detailing the terms of his appointment, i.e. his duties and powers, remuneration to be paid and other perquisites to be provided to him.

Further, the remuneration and perquisites should not be other than what are approved by the general meeting. Sec. 91 provides that the remuneration and other perquisites to be provided to directors should be approved by the general meeting. The validity of such agreement with the director at a time cannot exceed 4 years. This conforms to the provision that the term of director of a public company can be for a maximum of 4 years only at a time under Sec. 90(2). But if the term of the person to be appointed as managing director is less than 4 years, then the agreement

can for the term of his directorship only. The agreement may be renewed after he is reelected as director at the annual general meeting in which he retires.

This section has not made an exception in the case of a private company. This provision of appointing managing director applies to private companies also. There is further restriction in the case of a listed company. A person who is a director of a listed company can be a non-executive director of another listed company but could not draw any regular remuneration or perquisite as a managing director of another listed company. But this restriction does not apply to a non-listed public company and a private company. A person can be the managing director of more than one public company or private company other than a listed company and can draw remuneration from such other companies.

It is true that ordinarily the court do not unsuits a person on account of technicalities. But the question of authority to institute a suit on behalf of a company is not a technical matter. It has far reaching effects. It often affects policy and finances of the company. Thus, unless the power to institute a suit is specifically conferred on a particular director, he has no authority to institute a suit on behalf of the company such power can be conferred by the board of directors only by passing a resolution in that regard. But, however, the demarcation may be, there will always be a scope for clash between the two basic organs of the company, namely, shareholder and directors, as to their respective powers. An example of the clash which they are likely to pick up is *Automatic Self-Cleaning Filter Syndicate Co Ltd v Cuninghame.* [(1906) 2 Ch 34: 94 LT 651]: The company had power under its memorandum of association to sell its undertaking to another company having similar objects. By its articles the general management and control of the company were vested in the directors subject to such regulations as might from time to time be made by extraordinary resolution. Particularly important was the provision in the articles by which directors were empowered to sell or otherwise deal with the property of the company on such terms as they thought fit. The shareholders passed a simple resolution for the sale of the company‘s assets on certain terms and required the directors to carry the sale into effect.

On the director‘s refusal to do so it was contended by the shareholders that it was a mere question of principal and agent. The shareholders are the principal, and directors, the agents, and it would be an absurd thing if an agent should act like a dictator and manage the principal. But it was held that directors are agents not of a majority of the shareholders,but of the company,of the whole entity made up of all the shareholders. And if the whole entity of shareholders has entrusted the directors with a particular power a simple majority could not interfere in exercise of it.

In a subsequent case, FARWELL LJ observed:[*Gramophone & Typewriter Ltd v Stanley,* (1908) 2 KB 89: 99 LT 39] “Even a resolution of a numerical majority at a general meeting cannot impose its will upon the directors when the articles have confided to them the control of the company‘s affairs”. In another leading case [*John Shaw & Sons* (*Salford) Ltd v Peter Shaw & John Shaw*, (1935) 2 KB 113: (1993) All ER Rep 456 CA] GREER LJ explained the principle in the following words: “A company is an entity distinct alike from its shareholders and directors. Some of its powers may, according to articles, be exercised by the directors, certain other powers may be reserved for the shareholders in general meeting. If powers of management are vested in

the directors, they and they alone can exercise these powers. The only way in which the general body of the shareholders can control the exercise of the powers vested by the articles in directors is by altering their articles, or, if opportunity arises under the articles, by refusing to re-elect the directors of whose action they disapprove. They cannot themselves usurp the powers which by the articles are vested in the directors any more than the directors can usurp the powers vested by the articles in the general body of the shareholders".

This principle was followed in *Scott v Scott* [(1943) 1 All ER 582]. *Srinivasan v Subramania, [*AIR 1932 Mad 100: 136 IC 193,] where the directors were not allowed to exercise a power expressly vested in the shareholders] and applied to the case even of a private company. The court observed: "Under the articles of this private company the management of the business and the declaration of the interim dividends were both assigned to the directors. That being so, they were not subject to any control in that respect by the shareholders in general meeting. It is true that if the company in general meeting disapproved of the management or the declaration of an interim dividend, they could remove the directors, but the general meeting could not, as the articles stood, directly interfere by resolution with the management or the declaration of an interim dividend. The division of authority is important even in the case of what may be called family companies and having regard to the liability of directors as occupying a fiduciary position, it is necessary that it should be strictly observed".

Thus, the relationship of the board of directors with the general meeting is more of federation than one of subordinate and superior.

These principles have been generally followed by the courts in India. For example, in a case before Kerala High Court, by the articles of a banking company, the power of management was vested in the directors. The shareholders by a resolution pressed the directors to forego a debt. The court held that the directors were entitled to enforce the payment of the debt. [The directors of a company cannot be restrained from exercising their managerial powers in general, though they can be restrained in reference to some particular act. The courts may have to face practical difficulties in attempting to review the merits of the board's decision. "The courts have not been slow to acknowledge that their skill is not that of the businessman, and that the so-called business judgment doctrine acknowledges that it is both unfair to review, with the benefit of hind sight, the board's decision, and that the court is ill- placed to judge entrepreneurship". Ross Grantham, *The Content of the Director's Loyalty*, 1993 JBL 149].

Shareholders Intervention in Exceptional Cases

"But the fact should not be overlooked that the company is an institution owned and controlled by its shareholders. According to the legal theory the shareholder is the ultimate and final authority within the corporate enterprise. The inherent, residuary and ultimate powers of a company lie with the general meeting of shareholders. Thus the shareholders can interfere in management by replacing the existing management with a new one which would be more responsive to their and the company's interests". This aspect of the relationship between the directorate and shareholders has been highlighted in the decision of the Supreme Court in*LIC v Escorts Ltd* [(1986) 1 SCC 264 at pp 340-341] CHINAPPA REDDY J cited a passage from the speech of COTTON LJ [(1883) 25 Ch D 320: 50 LT 132]

It is very strong thing indeed to prevent shareholders from holding a meeting of the company, when such a meeting is the only way in which they can interfere if the majority of them think that the course taken by the director, in a matter *intra vires* of the directors, is not for the benefit of the company.

In the case before the Supreme Court, public financial institutions, including LIC were holding a majority of shares in the company. They requisitioned a meeting to remove nine directors. No reasons were stated. But the background was that the directors had refused to register certain transfers and had engaged the company in a calamitous litigation against the Government and also in a litigation to stay the requisitioned meeting and all this without consulting the principal block of majority shareholders who had so much at stake in the company. The Bombay High Court granted the stay. The Supreme Court vacated it. The shareholders had a right to meet and decide whether the destinies of the company were safe in the hands of the present management. The company had no right to say that the public financial institutions were going beyond their powers in trying to interfere in management, they being constitutionally only investing institutions. They have a right to be vigilant in safe guarding their investment and putting it in the hands of a management which can assure safety and security. In this respect they exercise their elementary right as shareholders. They do not thereby directly undertake to manage the company.

Now this power of shareholder has been incorporated in Sec.138 to Sec.140 of the Companies Act in the Chapter relating to protection of the shareholders.

Duties of Directors

Before turning to the substance of director‘s duties, the question is who their beneficiaries to whom the duty is owed are. At one level, the law is clear, they are owed to the company. The assets and liabilities of the legal personality of the company is an abstract concept. Its main function is to separate the assets and liabilities generated by the business of the company from those who invest in it, moneys work for it or deal with it. The common law, by contrast has rightly cleared the doctrine that the company means the company as a commercial entity distinct from the interests of any group of human beings who are involved in it. The traditional answer of the common law has recognized that the duties owed to the members of the company as a whole, the members being the person who created it and they stand last in the line to receive the economic benefits of the company‘s activities and therefore have the strongest incentive of all the groups involved with the company to monitor the Board effectively. If the company nears insolvency, the interest of the members is subordinated to the interest of creditors.

In common law, therefore the duties of directors are normally owed to the shareholders alone, as long as the company is a going concern and that to shareholder collectively and not individually.

Fiduciary Obligation (Duty of Good Faith)

Traditionally the duties of directors were non-statutory. They were fashioned out essentially from the common law as developed through the cases. But now company legislation of some countries has made a departure from this tradition. The Nigerian Act contains the following

provision on the point: "A director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf".

The first and the most obvious obligation of persons in fiduciary position are to act with honesty. "Greatest good faith is expected in the discharge of their duties". Good faith requires that all their endeavors must be directed to the benefit of the company. Thus where a director of a company, being also the member of another company, earned bonuses from the other company by providing some business facility of his company, he was held liable to account for such profits, although the company had itself lost nothing and also could not have earned the bonus. Where a director was aware of the fact that the company's property was being sold for £350,000 when its real value stood at £650,000, this was a breach of the fiduciary duty and since the recipient of the property was aware of this fact, he became a constructive trustee towards the company for his undeserved gain [*Aviling Barford Ltd v Perion Ltd*, 1989 BCL 626 Ch D; *International Sales and Agencies Ltd v Marcus*, (1982) 3 All ER 551, liability for giving away the company's property to an outsider without consideration and without shareholder's consent. This is on the basis of the principle that a person who receives money or property from the hands of a person knowing that the disposal was in breach of trust, would become a constructive trustee. The court applied the principle of the case in *Belmont Finance Corpn v Williams Furniture Ltd.* (1980) 1 All ER 393 CA. Before a person can be held liable as a constructive trustee it has to be shown that he is guilty of something amounting to dishonesty or want of probity. *Eagle Trust Plc v SBC Securities Ltd*, 1991 BCLC 438 Ch D; *Agip (Africa) Ltd. v Jackson*, (1989) 3 WLR 1367: 1990 Ch 265. Another case in which the recipient became liable because he had knowledge that he was receiving the shareholders money in *Houghton v Fayers*, [(2000) 1 BCLC 511 CA. *Saurashtra Cement &Chemical Industries Ltd v Esma Industries P Ltd.* (2001) 103 Comp Cas 1041 Guj]. The main object of the proposal to purchase shares in another company was to fulfill the personal obligation of directors, the proposal was restrained]. Where a company's funds were used to buy a house in the name of the wife of the majority shareholder and chairman, it was held that the money so applied was held in trust for the company. An order could be passed for tracing the money in the properties of the chairman. The directors of a family company were held personally liable to account for the money received by them on the company's behalf. The court conceded that it could look behind the corporate curtain for imposing such liability on directors.

The Managing Director and three other directors of a company devised a secret plan to set up a rival company and to leave jobs to join that company. Initially, the managing director resigned and left. The three others were allowed to continue for the time being. The managing director broke away most of the skilled workers of the company causing closure of the company. When the plot came to light, it was held that the managing director was perfectly free to proceed to set up a company of his own and invite employees from other organizations to join it. But the remaining three directors, who were still on the board, were under a duty to inform the company of what was going on. They were executive directors. They were held liable to the company for its losses for which sums had been assessed.

Directors Personal Profits

In *Hirsche v Simons* [1894 AC 654], on the eve of issuing a prospectus for additional capital, the assets of the company were revalued by a leading firm of surveyors and revised values were quoted. This brought about an increase in the market price of the company‘s shares. The directors sold some of their existing shares and obtained the benefit of the market situation. They were held by the House of Lords to be not accountable for this profit. Directors exercising their powers in a normal way are not accountable if the sensitive market is incidentally influenced creating opportunities of beneficial disposal of existing shares. In *Albion Steel and Wire Co v Martin,* [1875) 1 Ch D 580] a director sold certain goods to his company out of his personal stock but at the market price of the day, but even so he did make a profit because he had obtained the stock earlier at lower rates. He was required by the court to account for his profit.

Statutory Provision

Sec. 99(1) places a restriction on the directors that they should not do any work through the company or in connection with the business of the company, which would result in a personal profit to them. In spite of this restriction Sec. 99(2) provides that, if any director makes any profit in connection with the business of the company, the same shall become a debt to the company enforceable by the company. This applies to all the directors whether they are managing director or executive director or non-executive director. But the Act does not make them trustees of the profit so earned on behalf of the company.

Section 99(4) provides that every director or and officers, while holding their office, should act honestly, in good faith, for the interest and benefit of the company, and should exercise economy, caution, intelligence proficiency and skill as expected from Prudent person of general knowledge and discretion.

Directors Duty of Care, Diligence and Skill

Fidelity alone is not enough. A director has to perform his functions with reasonable care. He has to attend with due diligence and caution the work assigned to him. The Nigerian Act contains a set of provisions on this aspect of the directors' duties: “A director shall actual times in what he believes to be the best interests of the company as a whole so as to preserve the assets, further its business and promote the purposes for which it was formed, and in such manner as a faithful, diligent, careful and ordinarily skilful director would act in the circumstances”.

The New Zealand Companies Act, 1993 also provides that a director must exercise his powers for a proper purpose.

The courts have been very liberal in the matter of the expected standards of skill and care. An early example is *Overend Gurney & Co. & Co v Gibb* [(1872) LR HL 480. Prudential Assurance Co Ltd v Newman Industries Ltd (No 2), (1980) 3 WLR 543: (1982) Ch 204, 221: (1980) 2 All ER 841], no liability where assets reduced to less than liabilities. [But the Companies Act sec.60 makes the directors responsible if the assets reduced below its liabilities. (See below)] A company was formed to take over a private bank. Without investigating the value of the bank‘s assets and the extent of its liabilities and with knowledge that the bank was in a state of

insolvency, the directors paid £50,000 for goodwill. Still holding them not liable, the House of Lords laid down that there should be violation of either the Act or the memorandum or the transaction was such that no man of ordinary prudence would have entered into. In another case of overvaluation of assets, acquitting the directors, the court said that in order to make them liable their negligence must be in a business sense culpable and gross. Directors may not know the nature of the company's trade, because all that the law expects from them is that if they know they must use the knowledge for the company's benefit. Accordingly directors were held guilty of negligence when they participated in a transaction without trying to know whether the transaction was really for the purposes of the company or whether they were authorized by the Board in that respect, and it was no defence for any director to show that he believed that he was bound to sign because the other directors wanted it or that he joined under protest or that even without his joining, the other directors were determined to carry out the transaction. Directors were also held liable where they released the company's funds for paying a debt without trying to know whether anything really due and for purchasing assets without knowing whether there was any real transfer of those assets. Liability for negligence also followed where without any board resolution being properly passed a single member was allowed to manage a part of the company's business and he mis-conducted himself. A director would also be guilty of negligence where he discovers something wrong and, instead of informing the shareholders, rests content after pointing it out to the directors only.

Some objectivity into the standards of skill and care is expected from directors. "His duties depend upon the nature of the company's business and the manner in which the work of the company is distributed between the directors and other officials of the company. In discharging these duties a director must exercise some degree of skill and diligence. But he does not owe to his company the duty to take all possible care or to act with best care. Indeed, he need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience. It is, therefore, perhaps, another way of stating the same position that directors are not liable for mere errors of judgment". This is well-known observation of ROMER J in the celebrated case of *City Equitable Fire Insurance Company, Re* [(1924) All ER Rep 485: (1925) Ch 407: 133 LT 520. See also *Union Bank of Allahabad,*Re, AIR 1925 All 519: 88 IC 785; Govind v Rangnath, 32 Bom LR 232; *Parke v Daily News Ltd,*(1961) 1 WLR 493: (1961) 1 All ER 695]: One B was director of the City Equitable Fire Insurance Co. The company was ordered to be wound up. A searching investigation of the affairs of the company was then made and this investigation showed a shortage in the funds which the company should have been possessed of over £12,00,000. The collapse of the company was due to bad investments, bad debts and misappropriation. All the losses were due to B's instrumentality. He was accordingly convicted for his frauds.

But the question naturally arose as to whether during the period covered by B's nefarious activities the other directors were properly discharging their duties to the company? It was alleged that they were guilty of negligence in not detecting the frauds. But there was an exemption clause in the articles according to which the directors were liable only for gross negligence. The facts of the case did not disclose that degree of negligence and, therefore, the case of official receiver against B's co-directors failed.

Directors Responsibility to Maintain the Capital of the Company (Sec.60)

This section provides indirectly that the directors should maintain the capital of the company and should not allow its net worth to go down to half or less than half of its paid up capital. The net worth will come down like this only if the company continuously makes losses. That means that the directors have not been able to run the company in a profitable manner for the benefit of its shareholders and investors a like.

If the directors come to know of such a position, they should immediately start preparing the strategy benefiting the company as well as the shareholders within thirty five days of coming to know the financial position and place the strategy before the next general meeting of the shareholders. If it is necessary to have the approval of the shareholders to carry out the strategy, then an extra-ordinary general meeting should be called immediately to seek such approval.

Directors who neither prepare a program of strategy for further action by the shareholders, nor place the matter before the annual general meeting nor call the extra-ordinary general meeting or knowingly permit the existence of the situation where such meeting is not called, then the directors will be liable for punishment under the Act. If it is proved that due to mala fide intention or malicious recklessness the company‘s net worth has come down, then the director who so acted shall be responsible to pay compensation for such loss caused.

The strategy may be reviving the company by infusing more funds from the shareholders or winding up the company.

Exclusion of Liability now not Allowed (Sec. 201: The Indian Companies Act)

“This acquittal (in City Equitable case) caused such ferment as to lead to legislation abolishing contracting out”. Accordingly, the Act now does not allow liability for negligence to be excluded. Section 201 renders void any provision in the company‘s articles or in any agreement which excludes liability for negligence, default, and misfeasance, breach of duty or breach of trust. The company is also not allowed to indemnify its officers against such liability. The only exception is that where an officer has been sued or prosecuted on any of the above charges and the judgment is in his favoror he has been acquitted, or relief has been granted to him. The company may indemnify him against costs incurred in defence. An auditor has been held to be an officer of the company for the purposes of such indemnity. But where an auditor is retained only to conduct and carry out an audit function, without appointment as an auditor, he would not be an officer.

Under Sec. 99(5), if any director causes any loss to the company by acting in violation of Sec. 99(4) in bad faith, the company can recover compensation for such loss from such director. Here only director is liable.Other‘officers’mentioned in Sub-sec.(4)are not included to beliable.

Finally Sec. 99(6) lays down that it is the duty of the directors to comply with the Act, Memorandum of Association, Articles of Association and the unanimous agreement.

This Section applies to all companies, public, listed and private companies. Under Indian Act Sec. 319 to 321 puts restriction on compensation payable to directors on retirement, and denies compensation when he losses or resigns directorship in view of reconstruction of the company or amalgamation of the company. If any major shareholder / director holding control of the company sells their shares and receives extra payment for the 'control' transfer, then the same should be disclosed to the members of the company and approved by the company in general meeting. Where this is not done, the amount shall be held by the director in trust for the company.

Another method of acquiring the control of a company is by purchasing its shares. Shares may be purchased:

(a) by making an offer to the general body of shareholders;
(b) where the purchaser is a company, by inviting the company to become its subsidiary or a subsidiary of its holding company;
(c) by making an offer with a view to obtaining the right to control the exercise of one-third of the total voting power;
(d) by making any other offer which is conditional on acceptance to a given extent.

Here also those who acquire control will replace the existing management. The outgoing director may be induced on payment of money to facilitate the transfer of control, although outwardly the payment may have been made as compensation for retirement. If the transferee proposes to pay something to the directors, the latter must take reasonable steps to inform the shareholders of the particulars of such payment along with any notice of the offer made for their shares. Where this disclosure is not made to the selling shareholders, the directors may call a meeting of such shareholders and get the proposed payment approved before any transfer is made. But where they do neither, they shall hold the amount in trust for the shareholders who have sold their shares.

Section 321 (The Indian Companies Act) provides that any payment made by the transferee in pursuance of any arrangement entered into as a part of the agreement for the transfer of shares, or within one year before or two years after the agreement, shall be deemed to have been received as 'compensation for loss of office' or 'consideration for retirement' and liable to be accounted for. Similarly, if the price paid to a retiring director for his shares in the company is in excess of the price paid to other shareholders or any other valuable consideration has been given to him, it shall also be regarded as 'compensation' or 'consideration' and must be disclosed to the shareholders.

Under sec. 91(4) of the Act, it is provided that in the case of listed companies, when a director retires form office or is relieved from office, he shall not be paid any compensation for such loss office unless the compensation is approved by the general meeting. This limitation on payment of compensation does not apply to a non-listed public company, private companies and not for profit companies. In India such extra price paid shall have to be disclosed by the director to the general meeting and approved by the meeting of the company, as explained above.

In cases falling within the scope of the above sections, directors become trustees for those individual shareholders who have sold their shares for any profits made by the directors.

The scope of the disclosure obligation has been considerably widened in the United States. The interpretation of Rule 10B-5 of the Securities Exchange Regulations [Federal Securities Exchange Act, 1934] creates a situation where fiduciary obligations are no longer owed only to the current owners of the corporation, that is, the stockholders, but are also owed to outside non-stockholders. The insider owes a duty not only to refrain from stating falsehoods, or half-truths, but affirmatively to disclose allthe material facts of the transaction. [*Scienter and Rule 10B-5,* (1969) Col LR 1057 to 1061] The case of *Securities & Exchange Commission v Texas Gulf Sulphur Co* has become well known in this connection. The Texas Gulf Sulphur Co carried on certain drilling operations and discovered important mineral deposits. Before disclosing this fact to the public, the directors purchased the company‘s shares in the market and also acquired options to purchase further shares (calls). They also tipped their relatives and friends to purchase the company‘s shares. Ultimately, when the fact of discovery was made public, the prices of the company‘s shares soared up.

The SEC brought an action against the insiders to restrain them from purchasing shares unless a full disclosure of the facts was made and to offer restitution to those whose shares they and their ‘tippees’ had purchased. They contended that they had no intent to defraud and had in good faith withheld the information because any disclosure of this kind would have materially affected the prices of adjoining area as thus defeating the company‘s chances of acquiring the land at reasonable prices. But even so they were held liable. It is no doubt primarily the function of the management to decide when an information is ripe for disclosure, but in the meantime they should not operate in the company‘s stock market.

Misuse of Corporate Information

Exploitation of unpublished and confidential information belonging to the company is a breach of duty and the company can ask the director in question to make good its loss, if any. Any knowledge or information generated by the company is the property of the company, commonly known as intellectual property. Turnover of business, profit margins, list of customers, future plans, any person a luse of such knowledge is equivalent to misappropriation o fproperty. Use of such information can be restrained by means of an injunction. Any gain made by the use of inside information has to be accounted for to the company.

At common law, equity imposes fiduciary duties on directors because of their position of power in, and their relationship of confidence to, the company. In the course of their office, directors often can and do, obtain access to confidential information relating to sensitive transactions of the company. Also, information is acquired in circumstances where the recipient is required to keep it confidential. It is part of each director‘s fiduciary duty not to misuse this information. Each director owes a duty to the company not to disclose or use confidential information without the company‘s consent.

Sec. 99(4) ordains every director of a public company to take oath of confidentiality and good faith and honest dealings.

Insider Trading

Where the directors sold their shares before publishing half-yearly statements and the market went down after the publication because the accounts were not according to expectations, they were held liable to hand over profits to the company. Purchase of company‘s shares by directors cheaply with the knowledge that soon they were due to issue an offer to buy from willing shareholders at a higher price out of the company‘s reserves, made them accountable.

Apart from violations of the regulatory framework, directors’ dealings in their own company shares are not illegal. It is considered desirable that directors of listed companies should hold the shares of their companies. As a part of remuneration package, directors are often given share options which enable them to acquire shares in their company, which they may afterwards sell. When directors decide to sell their shares however acquired or to buy more shares, their trading comes to be governed by the legislation on insider trading. They commit an offence if they trade on some specific non-public information about their companies securities. For instance, if the director has access to unpublished price sensitive information, such as information on future earnings‘ figures, security issues, assets disposal and purchases, etc. which if it were made public would have significant effect on the share prices, it is illegal for them to trade on the information. Consequently, directors can trade in the shares of their own company but the trading must not be based on any inside information.

Outsiders Dealing in Insider Information

A dealer in a company‘s securities receiving inside information commits an offence under Section 1(3) and (4) of the Companies Securities (Insider Dealing) Act, 1985 (English) whether he procured that information from a primary insider by purpose or came by it without any positive action on his part.

The New Zealand Companies Act, 1993 imposes a new duty on directors, not to engage in reckless trading. This expression is defined in the Act as agreeing to cause or allowing conduct likely to create a substantial risk of serious loss to the company‘s creditors. The duty of directors in this respect has been thus explained: “The taking of business risks and allowing directors a wide discretion in matters in business judgment requires a sober assessment by directors as to the company‘s likely future income stream. Creditors are likely to suffer serious losses if future outflows of cash exceed cash inflows for the same period. If there is no profit margin on goods being sold or services provided the company will reach a stage where the shareholder’s risk capital has been exhausted and directors are instead using resources otherwise available to meet all creditors’ claims. In those circumstances, the company should have stopped trading. To continue trading is to risk creditor‘s money”.

Duty to Attend Board Meetings

Duties of directors are of intermittent nature to be performed at periodical board meetings. In other words, they are not bound to pay continuous attention to the affairs of the company.“They do not undertake to manage the company”. A director is not even bound to attend all the meetings of the board, although he is under an obligation to attend whenever in the circumstances he is reasonably able to do so. According to Section 283(g) of the Indian

Companies Act, the office of a director will be vacated if he absents himself from three consecutive meetings of the board without obtaining leave of absence from the board. Moreover, a director‘s habitual absence from board meetings may, taken in the light of other circumstances, become evidence of negligence on his part. In an early case in which liability was imposed for failure in this respect, the court said: ‘If some persons are guilty of gross non-attendance, and leave the management entirely to others, they may be guilty by this means if breaches of trust are committed by others’.

Duty Not to Delegate

Generally, a director has to perform his functions personally. He is bound by the maxim *delegatus non-potes delegare*. Shareholders have appointed him because of their faith in his skill, competence and integrity and they may not have same faith in another person. The rule is, however, not inflexible. In the following two cases at least delegations is proper and valid. Firstly, a delegation of functions may be made to the extent to which it is authorized by the Act or article of association of the company. Secondly, there are certain duties which may, having regard to the exigencies of business, properly be left to some other officials. Directors must be able to entrust details of management to subordinates, or else business could not be carried on. A proper degree of delegation and division of responsibility by the Board is permissible but not a total abrogation of responsibility since this would undermine the collegiate or collective responsibility of the Board of directors which is of fundamental importance to corporate governance. A director might be in breach of duty if he left to others the matters for which the Board as a whole had to take responsibility. These two exceptions permit a reasonable distribution of work among all the directors and other officials of the company. Now, if a co-director or other official to whom a function is so delegated commits a fraud and the company suffers a loss, to what extent are the other directors liable. This was the question before the House of Lords in the leading case of *Doveyv Cory.* [1901 AC 477:(1895-9) All ER Re 724]: A banking company had suffered heavy losses on account of advances of money made to irresponsible persons and without security; and also on account of payment of dividends out of capital. These losses were due to the mechanism of the chairman and the manager who manipulated the accounts and showed a profit. At a meeting of the board, the defendant was ensured of the correctness of the accounts and, therefore, he gave his authority to the payment of a dividend which was obviously paid out of capital.

He was sued for the losses, but was held not liable. Lord HALSBURY observed: “Each and all of the charges may be disposed of by the proposition that Mr. Cory was not himself conscious of any one of these things being done. Was he under a duty to probe into and know these things ? It cannot be expected of a director that he should be watching the inferior officers or verifying the calculations of auditors. Business of life could not go on if people could not trust those who are put in a position of trust for the express purpose of attending to the details of management. He could have been held liable only if he had some reasonable grounds to suspect the honesty of the other officials”.

This principle was followed by the *Madras High Court in D. Doss* v *C. P. Council*. [AIR 1938 Mad 124]. An undischarged insolvent, having been appointed advisory director of a banking

company, misappropriated a part of the security money received from the employees of the company which was at his disposal.

The ordinary directors of a company are entitled to presume in the absence of features arousing their suspicion that the affairs of the company are being properly conducted by the managing director and the managing committee, and unless any mismanagement or other act of misfeasance is brought to the notice of the directors, they cannot be held liable in respect of the same.

On the same principle, directors were held not liable for misappropriation of stores by the store manager, or for failure to detect cashier‘s concealment of overdrafts, or for payment of dividends on false accounts declared at a meeting where the director sought to be made liable was absent, or for allowing, by one of the two directors, the company‘s premises to be used for gaming purposes without license, the other director knowing nothing.

“A director is also permitted to rely on professional or expert advice given by reliable competent employees, professional advisors and experts, and other directors. This is provided the reliance is in good faith, after proper inquiry when appropriate, and without knowledge that the reliance was unwarranted. A prudent director aware that he or she lacked expertise in a particular area could avoid potential liability by obtaining the advice of an expert. In common with other provisions in the Act, the best way a director can protect him or herself from later liability is to lay a ‘paper trail’ before entering into any transaction or carrying out any action”.

This, however, does not mean that directors can always throw up their hands and say, ‘weknew nothing and believed that everything was alright’. Sometimes it is their duty to know.These words of Lord SIMONDS in *Morris v Kanssen*, though spoken in a different context, were borrowed by NAIR, J of the Kerala High Court in deciding the typical case of *Palai Central Bank Ltd v Joseph Augusti.* [(1966) 1 Comp LJ360]: The accounts of a banking company in liquidation showed that taxes and dividends were paid for as many as twenty-two years (i.e. from 1936-1958) on profits not really earned, but made to appear firstly by fictitious entries, and subsequently by showing interest, which there was no prospect of ever realizing, on the bad and irrecoverable advances. The length of time was by itself a sufficient proof of the deliberateness of the falsification.

The court rejected the directors’ plea that they had relied on competent staff and auditors who always certified the accounts as true. Referring to the magnitude of the loss involved, which could not be easily explained, the court said: “Not one of them has cared to disclose who were the persons in actual charge of these matters, what exactly were the duties imposed on them, and what scrutiny there was over their work in order to assure that it was properly done. At best the plea of respondents can only amount to a plea of complete ignorance born of a complete inadvertence to their duties, as directors, a reckless indifference, or, otherwise put, a willful shutting of their eyes. The deliberate falsification of the books year after year could not have been the handiwork of the staff of the company; it could only have been at the specific instructions of those at the helm of affairs. In a company, the directors are at the helm of affairs,

and although the rudder might be in the hands of the managing director, it is their duty to keep an eye on him and see that he steers a proper course.

Similarly, "the position of a managing director or chairman of the board of directors is different. He cannot say that he signed the accounts without understanding the implication of its entries". [*Official Liquidator v Shri Krishna Prasad Singh*, (1969) 1 Comp LJ325]. The Managing Director was held liable for misappropriation but not his co-director [*National* Sugar Mills Ltd: (1978) 48 Comp Cas 339 Cal]

Duty to Disclose Interest [Sec. 299-300: The Indian Companies Act]

Conflict of Interests

Every agent occupies a fiduciary position towards his principal. As such it is his duty to see that his personal interest and his duty to his principal do not conflict. For the proper exercise of the functions of a director, it is essential that he be disinterested, that is, be free from any conflicting interest. This principal was established in the leading case, *Aberdeen Railway Ltd v Blaikie* [(1854) 1 Mcy 461]. There, Blaikie had a conflict of interest as director and chairman of the company and managing partner of a firm which supplied office furniture to the company. Despite the fact that the price the company paid for the furniture was fair, the company was entitled to set the contract aside. The judgesaid: "A corporate body can only act through agents and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interest of those whom he is bound to protect".

Blaikie had an interest as a partner in the firm to sell as high as possible but an interest as director, of the company to purchase as low as possible. The fairness or otherwise of the price was irrelevant; what the court considered was the *possibility* of unfairness.

In the first place, a director who is interested in a transaction of the company is required to disclose his interest to the board (Sec.92). The disclosure must be made at the first meeting of the board held after he has become so interested. If he is a member of a company or of a firm with which the company has to deal he may give a general notice to the board of his interest in that concern. Such notice must be renewed after every year.

Secondly, (Sec 97) an interested director is not allowed to take part in the discussion by the board on the matter of his interest. Neither shall he vote nor shall his presence count for the purpose of quorum. It he does vote, his vote shall be void.

As noted above, these provisions are based upon the sound principle that the company is entitled to the unbiased advice of every director upon matters which are brought before the board. It is possible, of course, that a person may be altruistic and in coming to an arrangement in which he is concerned he will give better terms to the other contracting party than if he had no interest at

all, but persons of such disposition are not usually found among the directors of a company and it must be assumed that in the making of an arrangement a man will consider his own interest rather than the interest of the other contracting party.

What constitutes "Interest"

This obviously raises the question as to what constitutes an 'interest' within the mischief of the rule. The interest to be disclosed is that which in a business sense might be regarded as influencing judgment; the essence of the matter being that any kind of personal interest which is material in the sense of not being insignificant must be revealed. In short, the interest must be such which conflicts with the director's duties towards the company. Thus, for example, where the directors took part in and voted at a meeting of the board which granted debentures to two of them, the resolution was held to be bad.

Only such interest comes within the mischief of the rule and has to be disclosed which is 'personal' in the business sense of the word. Thus the appointment of a director as a chairman or as a managing director is not such an interest and the appointment will, therefore, be valid even if the director to be appointed was present at the meeting and voted. But in *V. Ramaswami Iyer v Madras Times Printing & Publishing Co;* [AIR 1915 Mad1179]. Under a company's articles two directors constituted a quorum for a meeting of the board. Two were present and they appointed one of themselves as managing director and co-editor of the paper run by the company. The appointments were held to be invalid as when the vote of the interest director was excluded there was no quorum to make the appointment in each case.

Accountability for Profit

The director in question is bound to hand over the benefits, if any, that he might have secured under the transaction and he cannot ask for set off for any claim that he may have against the company. This is the grand contribution of the decision of the House of Lords in *Guiness plc v Saunders* [(1990) 1 All ER 652 HL: (1990) 2 WLR 324]. The plaintiff company launched a takeover bid for another company. W and two other directors formed a committee of the board for the purpose of conducting the bid. A company controlled by W submitted a bill for £5.2 m by way of remuneration for services rendered in connection with the take-over. The calculation was in terms of a percentage linked with the amount involved in the take-over. W claimed that the payment was under an agreement with the company, but, in fact, it was only under an agreement with the committee of directors and the fact that he had become interested in the transaction by linking his remuneration with the takeover amount was also disclosed only to this committee. He was compelled to refund the whole amount to the company. The matter of his interest had to be disclosed at a meeting of the full board of directors duly convened and not merely to a sub-committee of directors. He thus held the money as a constructive trustee and was obliged to account for it irrespective of any cross-claim he might have by way of *quantum meruit* or equitable compensation for services rendered.

General Consequences of Default

According to *ISSAC J* of the Kerala High Court the consequences of default under the section are:

(1) Liability to be prosecuted under Section 160(a), (g), (h), (i), (j);
(2) Cessation of the office of directorship under Section 89(1)(f) & 89(3)(e);
(3) Liability to be prosecuted under Section 160 (l) for acting as director after incurring a disqualification; and
(4) Liability to refund remuneration.

(Sections above are of Companies Act, 2063 corresponding to the Indian Companies Act sections quoted in the Judgment)

MEETINGS OF DIRECTORS

Directors of a company have to exercise most of their powers at periodical meetings of the board. It is, therefore, provided in Section 97 that in the case of every public company, a meeting of its board of directors shall be held at least six times in a year and interval between the meetings should not be more than three months.

Notice

Notice of every board meeting has to be given in writing to every director. 'The Act does not prescribe the form of notice or mode of service and if the directors are duly informed that in future meetings would be held on the first Saturday of every month, it is a sufficient compliance of the statute'. Failure to give notice to any director renders the meeting invalid, and the business conducted at it is void. Explaining the role of the chairman in a subsequent case, the Supreme Court said: [*Nazir Hoosein v Darayus Bathena,* (2000) 5 SCC 601: AIR 2000 SC 2427: (2000) 37 CLA]: "The chairman of the Board of Directors is the central figure in holding the meeting and is the controlling factor in the conduct of the meeting. He authenticates the minutes of the meeting and performs such other functions as empowered under the Companies Act. A chairman is always elected by the Board of directors; thus he has the full support of the majority of Directors which helps him in the control of the meeting and recording authenticated minutes".

The notice need not specify the agenda for the meeting. The agenda may be set out as a matter of prudence, but it is not required. Even where agenda is specified, the directors need not confine themselves to it. Any other business conducted at the meeting would be equally valid. Any other rule would be extremely embarrassing in the transaction of the business of companies. However, the members of the board should not be taken by surprise particularly over serious matters. A notice convening a meeting was held to be invalid because it did not specify that the meeting was being called to consider and approve the transfer of controlling interest in the private company and that too in violation of the pre-emptive provisions in the company's articles.

The law also does not prescribe any length of notice. 'A few minutes' notice may suffice'. Even a chance meeting of directors may be resolved in to a board meeting. In Smith v Paringa Mines Ltd.: "A directors' meeting was duly summoned for filling up a vacancy. There were only two directors *T,* and *B, B,* being the chairman. T did not attend. *B* went to *T*'s personal office and met him in passage outside his office. While standing there proposed *F's* name. *T* objected. *B,* being in the chair, gave his casting vote and declared *F* elected".

The court upheld the election and said: "There is no reason why a meeting should not be held in the passage". As against it, in another case the only two directors of a company were not on speaking terms, for which reason it became necessary to appoint additional directors. One of them, *P,* waited for the other, *C,* at a railway station and finding him alighting from a train proposed three names. *C* remained silent. Thereupon *P* gave his casting vote and declared the three directors has elected. But the court did not uphold these appointments. "A director cannot have a board thrust upon him without his consent and against his will".

In this respect meetings of board are immensely different from those of shareholders which have to be held in an atmosphere of considerable formality.

Quorum

The quorum for a meeting of the board under Sec. 97 (4) of Companies Act, 2063 is at least 51% of total number of directors. But any director having interest in the agenda to be discussed shall not be counted for quorum.

But where this quorum cannot be formed, due to any reason it can be called again by giving at least three day notice. If at such meeting 51% of the total number of directors is not present, decisions made by the directors present will be valid. In such case quorum is not required for discussion and decision.

Proceedings

The manner of conducting the business of the board is something to be provided for in the articles. According to Sec. 97(6) matters arising at any meeting of the board are to be decided by a majority of votes. The chairman may be given a second or casting vote in case of an equality of votes. Matters decided are put in the form of resolutions proposed and approved. A resolution may be passed either at a meeting of the board or by circulation. Section 97(9) requires that if a resolution is to be passed by circulation it should be circulated in draft, together with all the necessary papers, to all the directors and should be approved by all members. The resolutions of the board, even if passed by a majority, are binding on all the directors and all of them are bound to help others in carrying them out whether they voted with or against the majority.

Minutes

Under Sec. 97(7), a separate minute book of the Board meeting shall record the directors who were present, matters discussed and the decision taken. The same should be signed at least by 51% of the directors present at the meeting. If any director opposes the resolution or gives alternate opinions, such opposition and alternate opinion should be recorded in the minutes. Only be reason that any director has not signed the minutes, the resolution shall not be deemed to be invalid. But such resolution may be invalidated for other substantial reason as fraud or malafide etc.

Register

Under Sec. 107, a company has to maintain a Register of Directors giving the following particulars: Name, Surname and address of every director, nationality of director, his occupation,

date of appointment as director and the date of renewal from directorship. If any change occurs in the details, the same should be intimated to OCR within 15 days.

Register of Directors Shareholdings

Sec. 94 lays down that a director, if he acquires interest in any shares or debentures of the company or its subsidiary or holding company or others subsidiaries of holding company, he should inform the company of the same.

For the purpose of this section the word 'director' would include any person in accordance with whose directions the company's board is accustomed to act, and also any other company whose board is accustomed to act according to the directions of a director, or if such director holds one-third of the voting strength in that company. Directors are obliged to make necessary disclosures to enable the company to prepare the register.

Appointment of Directors

Normally, the appointment of directors is made at the general meeting by the shareholder. In the case of first directors before the holding of the first annual general meeting, the directors may be appointed by the promoters or as provided in the Article of Association. Under the Indian Companies Act, in the absence of any regulation in the matter, the subscribers to the Memorandum who are individual shall be the first directors.

The appointment of directors in a private company and the number of directors shall be as provided in the Articles of Association. However, the number of directors shall not exceed 11.

In the case of public company, there must be minimum three directors and can be a maximum of eleven directors in the Board. In case of a public company consisting of women shareholder, there shall be at least one woman director in the board of directors Sec. 86(2).

If the number of directors prescribed in the case of a public company is up to seven persons, then at least one director, and if the number of directors are more than seven, then at least two directors, with qualification as prescribed in the Articles, not disqualified Sec. 89(2) and having knowledge about the business of the company should be appointed as independent director/s, while constituting the Board of Directors.

A person elected among themselves by the majority of directors shall be the chairman of the Board of Directors.

Alternate Director

Generally in England and India, if any director goes out of the country and is unable to attend the Board Meeting, he may appoint an alternate director. But under the Companies Act, 2063 only in the case of directors nominated by a corporate body proportionate to its shareholding, then that corporate body may appoint an alternate director. If the director so nominated is unable to attend the Board meeting, he shall inform his alternate director as well as the Board of Directors. In that case, the alternate director may take part in and vote at the Board meeting.

Qualification Shares

It is a condition that a person to become a director should hold qualification shares as prescribed in the Articles of Association. If the Articles of Association does not prescribe any qualification shares, he shall have taken at least 100 shares in the company. (Sec.88) But a director nominated by corporate body and an independent director need not hold any shares in his name.

Under the Indian Companies Act, if the director does not hold any qualification shares on the date of his appointment, he should acquire the qualification shares within 2 months of his appointment. But in Nepal, without holding the shares, one cannot be appointed as the director.

DISQUALIFICATION FROM BEING APPOINTED AS A DIRECTOR OR CONTINUING AS A DIRECTOR

Sec. 89(1) prescribes the disqualification for appointment and Sec. 89(3) prescribes the disqualification which will disentitle a person to continue as a director of the company once appointed.

Disqualification for appointment [Sec. 89(1)]

The following conditions have been laid down listing the disqualification for a person to be appointed as a director of a company:

(a) In respect to a public Company, those who have not attained 21 years ofage;
(b) Those who are insane or of unsound mind;
(c) Those who have been declared insolvent, and five years have not elapsed since then;
Note: After the expiry of five years from the date of his declaration as insolvent, he will be eligible to be appointed as a director of a public company as well as private company;
(d) Those who have been punished for having committed any offense relating to corruption or any other offense involving moral turpitude. However, in the case of a private Company, those who have not completed three years from the date of completion of such punishment will not be eligible to be appointed as a director;
In this case, the person is not eligible to be appointed s director of a public company for ever but can be appointed as director of a private company after the expiry of three years from the date of punishment.
(e) Those who have been convicted of theft, cheating, forgery or fraud, or of misappropriation or misuse of cash or goods entrusted to them, punished accordingly, and have yet to complete three years after the date of completion of such punishment;
Note: In this case, after the expiry of three years, he can be appointed as director of any company.
(f) Those who have any personal interest in any business or any contract, agreement or transaction of the concerned Company;

Note: This section makes a total prohibition on appointment of any person having any personal interest. But sec. 92(1) requires such a director so appointed to give written notice of his personal interest to the company. Again under sec.93(1), it is stated that a public company can enter into transactions of substantial nature in which any director or his relatives or associates may be interested only with the consent of the general meeting. Thus these sections appear to contradict each other. In other countries, there is no total prohibition

on appointment of directors having personal interest in dealings with the company of which he is a director.

(g) Those who are working as a Director, substantial shareholder, employee, auditor or advisor of any other Company having identical objectives, or who have any kind of personal interest in any such Company. However, any such person of a private Company may become a Director of any other private company.

(h) Those shareholders who are held to have yet to pay any amount due to the concerned Company. Such person can make payment of the amount due just before his being elected or appointed as director and prove that no amount is due from him;

(i) In the case of those who have been punished under Section 160, those who have yet to complete one year from the date of punishment, or, in the case of those who have been punished under Section 161, those who have yet to complete six months from the date of punishment;

(j) In case current law has prescribed any qualification in respect to any Company operating any particular type of business, those who do not possess such qualifications, and in case such law has prescribed any disqualifications, those who are so disqualified;

(k) Those working as Directors of a Company which has failed to submit to the Office statements and reports to be submitted under this Act for three consecutive financial years;

(k1) Those working as Directors of any other listed Company with a provision to be provided with remuneration or any facility other than the meeting allowances and the actual expenses to be incurred for traveling to and from the venues of meetings;

(l) A person who has yet to pay fine as per sub-section (2) of section 81.

Disqualification for Continuing as a Director of a Company [Sec. 89(3)]

(a) If circumstances as mentioned above arises for disqualification from appointment;

(b) If a resolution is passed by the general meeting to remove the directors. An ordinary resolution passed by majority vote issufficient;

(c) If the resignation given by the director is accepted by the Board of Directors;

(d) If the Court finds any dishonesty or bad faith in the carrying on of the business of the company, here Court‘s order is necessary. Mere filing a case against them will not disqualify them from continuing;

(e) If the Court decides that the director has done an act which he is not supposed to do or has not done something which he has to do under the Act, here also the Court‘s finding is necessary;

(f) If he has been blacklisted by the authority for not repaying the loan taken from any bank or financial institution and the period of blacklisting continue. The person may be black listed in respect of loan not connected with the company. Once his name is removed from the black list, he can again continue to be the director.

Disqualification for Being Appointed as Independent Director (Sec. 89(2)]

None of the following persons may be appointed to the post of an independent Director:

(a) Persons who are generally disqualified to be appointed as a director;

(b) Shareholders of the concerned Company; (that means he can be a shareholder of the holding company or any subsidiary or associated company, which will not be disqualification)

(c) Persons who have not acquired at least a Bachelor's Degree in a subject connected with the subject of business of the concerned Company and gained at least 10 years' experience of work in the concerned field or in functions relating to Company management, or those who have not acquired at least a Bachelor's Degree in economics, finance, management, accounts, statistics, commerce, business administration or law and gained at least 10 years' experience of work in the concerned field;
(d) Those who have yet to complete three years after being retired from any post of office-bearer, auditor, employee or any other similar post of the concerned Company;
(e) Close relatives of the office-bearers of the concerned Company;
(f) Auditors of the concerned Company or their partners.

The concept of independent director is new concept developed under "corporate governance" and has been copied from India. After the recent "Satyam episode" in India, a rethinkinghas started how to make the independent directors really independent. So long as their appointment depends on the familiarity with the existing directors and remuneration from the company at the mercy of the operating directors, their independence cannot be vouchsafed. How effective they will be in their performance in checking the management from doing unlawful or unethical acts is yet to be seen.

Sec.89(4) lays down that any person to be disqualified to be appointed as the director or for continuing to hold the office of director, reasonable opportunity should be given to the concerned person with the information purporting to make him disqualified to give his explanation, if any, to defend himself.

Term of Office and Casual Vacancy

In case of vacancy created by death or resignation or other disqualification mentioned in Sec.89(3) of the existing directors, casual vacancy is created under proviso 3 to Sec. 90(2), the Board of directors can appoint a person who is not disqualified to be the director in the casual vacancy created. Such director specifically appointed to fill the casual vacancy will hold office till the time the director in whose place he was appointed would normally retire.

But the Board can desist from appointing a director in the casual vacancy, thus postponing the appointment to the next annual general meeting to be held.

Under Sec. 90(2), in case of public company, the maximum period for which a director shall hold office shall be 4 years, subject to the Act, the Articles of Association. The Articles of Association may provide for less than 4 year also. Since the director are appointed at the Annual General Meeting, the director will normally hold office till the end of 4th annual general meeting held after the general meeting at which he isappointed even if the BoD full tenure expires prior to it.

Section 257 of the Indian Companies Act provides that for appointing a person other than the retiring directors, a proposal by the proposed person or any other member should be given notice of to the Company at least 14 days before the date of annual general meeting and it is to the duty of the company to inform his candidature to the members of the company at least seven days

before the meeting. But, in the absence of such clear provision, it becomes the prerogative of the existing board members to select the candidate and inform the members. But no duty is cast on the company to receive such nomination and process the same and inform the shareholders of the candidates. But under Sec. 77(2) members having voting rights of not less than 5% of the total voting rights might propose the matter by giving notice to the company before issue of notice calling the annual general meeting. But this is at variance to the England and India Act, where any member whether he holds not less than 5% voting rights or not can give notice of the resolution proposing the name of a person for the post of director.

Further, the Act does not provide for not holding general meeting or failure to appoint directors at the annual general meeting. Sec. 166(1) of the Indian Companies Act makes a clear provision that a director who is to retire by rotation at an annual general meeting as also an additional director appointed by the Board of Directors, cannot continue in office after the last day in which the annual general meeting in each year should have been held. The reason is that directors who are responsible to call annual general meetings, does not continue in office by their default to hold the annual general meetings. This position is well established in England and India by the rulings of the Court. In re: consolidated Nickel Mines Ltd [(1914) 1: Ch: 883] followed by the Courts of India.

Further, in the case of failure of the annual general meeting to elect any directors, Sec. 256 of the Indian Companies Act, the retiring directors shall be deemed to have been re-appointed so that the management of the Company is not crippled. But such automatic re-appointment is subject to the following conditions, namely, unless:

(a) the company has resolved not to fill the vacancy of the retiring director;
(b) a resolution for re-appointment of such director was put to vote and lost;
(c) the retiring director has informed in writing his unwillingness to continue as director;
(d) he is disqualified to continue as director;
(e) a resolution, whether ordinary or special, is required to be passed at the meeting for appointing him as a director.

The above conditions also apply to Nepal with regard to re-appointment of a retiring director even though not for automatic re-appointment till AGM.

In the case of private companies, the matters relating to appointment, retirement etc. will be governed by the provision in the Articles or the unanimous agreement of the shareholders.

Additional Directors

The Companies Act does not provide the appointment of additional director. Thus unless the articles provide for the same, any additional directors will have to be appointed at the annual general meeting only.

Suppose, if the Articles provides for the total number of directors to be 10 but at present there are only 7 directors. Therefore, there is vacancy for appointing additional directors till the number reaches 10. Usually Articles provide that the Board could appoint directors to fill such vacancy and such person so appointed will hold office till the next annual general meeting which

should re-appoint him. In the absence of re-appointment, at the annual general meeting, he cannot continue as a director. But whether to appoint the additional director or not is the prerogative of the Board of Directors and the shareholders cannot compel the Board to get additional directors elected at the annual general meeting, unless Articles give such powers to the shareholders.

Consent of Directors

If any shareholder desires to become a director of any company, s/he has to file his/her candidacy subject to Companies Act, 2063. Under Indian Companies Act, Sec. 264 provides that any person, other than the retiring director, who has given notice signifying his candidature for the office of director or proposed as a candidate for the office of director shall sign and file with the company his consent in writing to act as director, if appointed. A person other than the retiring director (either on expiry of his term of office or being appointed in the place of casual vacancy or as additional director and mentioned as a director in the Article) shall not act as a director unless he files with the Registrar his consent in writing to the registrar to act as director within 30 days of his appointment.

This is intended to prevent the newly appointed director from saying later that he had been appointed without his consent. Further, Sec. 107 of Companies Act, 2063 requires that the appointment of directors or any change in directorship should be intimated to OCR along with return Sec. 92 of the Act.

Remuneration of Directors

Under Sec. 91 of the Act, the Board meeting allowance, monthly remuneration, daily allowance and traveling allowance or other perquisites and facilities shall be decided by the General Meeting. But until the first Annual General Meeting is held at which the directors are regularly elected, the remuneration and other facilities of the managing director or full time director shall be decided by the Board of directors. Generally, the Board meeting allowance is mentioned in the Articles of Association and to increase the same, a special resolution is required. But where article provides that the same shall be decided by the General Meeting, then the General Meeting can increase the meeting allowance by an ordinary resolution.

In addition to the above, only in the case of full time directors, the general meeting may allow as an incentive up to 3% of the post-tax projects by a special resolution passed at the meeting. But in case, the actual tax liability is more than the tax liability on the basis of which the past tax profit was arrived at then the excess tax, if any, to be paid will have to be borne by the directors who are entitled to the incentive in a proportionate manner up to the limit of remuneration received by them. However, if the additional tax amount to be recovered from the concerned recipient directors is more than the remuneration received by them, then they will have to return on a proportional basis up to the extent of the remuneration received.

13 DEBENTURES

The legal relationship between a company and its debenture-holders is simply the contractual relationship of debtor and creditor, coupled, if the debt is secured on some or all of the

company's assets, with that of mortgagor and mortgagee. In contrast with a shareholder, the debenture-holder is in law not an owner of the company having rights in it, but a creditor having rights against it. In reality, however, the difference between him and a shareholder may not be anything like as clear-cut, for the debenture may give the holder a contractual rights akin to those of a shareholder, e.g. to appoint a director, to a share of profits (whether or not available for dividend); to repayment at a premium; to attend and vote at general meetings and even to convert his debentures into equity share. Covenants in the loan instrument may also give the debenture-holders considerable influence over the way in which the company is managed. Moreover, where the debenture is secured by floating charge on all the undertaking and assets of the company, the holder will have a legal or equitable interest in the company's business, albeit of a different kind from that of its shareholders.

It is difficult to precisely define the term 'debenture' either in law or commerce, a strictly technical term. The definition that we get in the Act is 'debenture is the loan bond issued by a company either giving security of its properties or without securities'.

The normal debenture is however very different from a single mortgage of land. It generally consists of one of a series of securities relating to *pari passu* with each other. Without this, their respective priorities will depend on the dates when each debenture was issued.

The expression 'debenture' is applied indiscriminately to the investment creating or evidencing the indebtedness and to the debt itself and the bundle of rights vested in the holder to secure payment. These rights may include a charge on all or some assets of the company. If there is no such charge, it is simply called a 'bond' or a 'loan note'.

Nepal Companies Act does not recognize debenture stock which (like cutting gold while selling) can be issued according to the price paid by the investor out of the total issue.

If a public company wishes to raise Rs.1 million it could seek to do so by an issue of a series of, say Rs.1, Rs.10, Rs.100, or Rs.1,000 debentures, each representing a separate debt totaling in aggregate Rs.1 million. And, if a subscriber for a single debenture wanted to sell half of it, he would not be able to make a legal transfer of that half. If, however, the company creates Rs.1 million of debenture stock it can issue it to subscribers in such amounts as each wants, giving each a single certificate and he can sell and transfer any fraction of it. That is a person can purchase debenture stock of Rs.435 face value and sell out of it Rs. 215 face value of debentures. A further advantage is that, whereas with a series of debentures with a charge on the company's assets it will be necessary to say expressly in each debenture that it is one of a series ranking *pari passu* in respect of the charge, debenture stock achieves that result without express provision.

Kinds of Debenture

Redeemable Debentures

Debentures are generally redeemable. This means that on expiry of the term of the loan the company has the right to pay back the debenture-holders and have its properties released from the mortgage or charge. This is called redemption of debentures. Redeemed debentures can be

re-issued. This power is expressly given by Section 121 of the Indian Companies Act. According to this section, if there is no provision to the contrary in the articles, or in the conditions of the issue or if there is no resolution showing an intention to cancel the redeemed debentures, the company shall have the power to keep the debentures alive for the purpose of re-issue. The company may re- issue same debentures or other debentures in their place. Upon such-re-issue the person entitled to the debentures has the same rights and priorities as if the debentures had never been redeemed.

Perpetual Debentures

A debenture which contains no clause as to payment or which contains a clause that it shall not be paid back is known as a *perpetual or irredeemable debenture.* Section 120 of the Indian Companies Act provides that a 'condition contained in any debenture shall not be invalid by reason only that thereby, the debentures are made irredeemable, or redeemable only on the happening of a contingency, however remote, or on the expiration of a period, however long'.

Registered Debentures and Bearer Debentures

A company which has issued debenture will obviously maintain a register of its debenture-holders, as Section 46(3) of Companies Act, 2063 provides that every company shall keep a register of the holders of its debentures. The name of the holders is placed both on the debenture certificate and on the company's register. Such a holder is known as the registered holder. He can transfer his debentures in the open market in just the same way as shares are transferred. Transfer will have to be registered with the company. The transferee's title will be subject to all equities between the transferor and the company. Registration of transfer can be avoided only by issuing debentures payable to bearer. Such debentures are transferable, like negotiable instruments, by simple delivery and are called debentures payable to bearer. The negotiable Instruments Act applies and, therefore, every holder of a bearer debenture is presumed to be a holder in due course unless the contrary is shown. But bearer debentures are not permitted at present.

Shareholder Compared with Debenture Holder

In many respects, debentures are similar to shares. In the words of Gower: The company's securities fall into two classes which legal theory tries to keep rigidly separated but which in economic reality merge into each other. The first of these classes is described as shares; the second as debentures. Some of the resemblances between the two are that both the shareholder and the debenture-holder have invested their money in the company; both get some return on the investment, although one gets it by way of dividend and the other by way of interest; perpetual or irredeemable debentures, like shares, are not generally paid back; debentures, like shares, are transferable; and where debentures carry a charge, the lot of debenture-holders, like that of shareholders depends upon the assets of the company. Moreover, redeemable preference shares and debentures have many common features. The company can pay back both such securities. The position of the shareholder is undergoing serious transformation. Indeed, if may be questioned whether shareholders should remain in their present position as owners of the business or be converted into some form of creditors of the business. There are suggestions to

the effect that companies should issue participating debentures so as to provide the small saver with adequate return of interest plus a participation in the profits.

The following points of difference are, however, also quite apparent. In the first place, the basic difference is that while a shareholder is a member of the company and enjoys all the rights of the memberships, a debenture-holder is simply a creditor of the company. A shareholder, for example, has the right to vote, whereas Section 117 declares that 'no company shall issue any debentures carrying voting rights at any meeting of the company, whether generally or in respect of particular classes of businesses.

Secondly, the debenture-holders are entitled to a fixed rate of interest which the company must pay whether there are profits or not. But they do not have any right to interfere with the business of the company unless, on the company's default, they step in to enforce their security. Shareholders, on the other hand, have the full right of control and the ultimate destiny of the company is in their hands. Of course, they are entitled to get dividends only of profits, but the rate of dividend may be much higher than the rate of interest.

Thirdly, unless the debentures are perpetual, the company can pay back the debenture-holders but the shareholders cannot be paid back as long as the company is a going concern.

Lastly, in the winding up, debenture-holders; being secured creditors, are paid in priority. Where as shareholders are paid back only after all other claims have been satisfied.

Issue and Transfer of Debenture

Issue and transfer of debenture are more or less similar to that of the shares. A public company issuing debentures will have to follow the same procedure as for fresh issue of shares. But there are certain basic difference between debentures and shares.

Debenture	Shares
Debenture holder are lenders and creditors of the company.	Shareholders are the owners of company.
Rights depend on the debenture deed terms, independent of the Articles.	Rights are as described in the Articles of Association.
There can be no restriction on transferability.	Articles may provide restriction on transferability.
There can be no lien of the company on debenture.	Company can have a lien on shares.
The terms of debenture deed can be amended by the trustee without holding any meeting of the debenture holders.	Shareholders rights can be amended only by a majority of members meeting by a special resolution.
Redeemed debenture can be re-issued with their original priority.	Redeemed or repurchased shares cannot be reissued.
Debentures secured by charge on the property of the company, throw up problems regarding	These are clearly defined in the Articles and no conflict between different classes of

the priority between conflicting interests of charges.	shareholders normally arise.
Debentures are entitled to fixed rate of interest, whether there is profit or not.	Can be paid dividend only if there is sufficient profit and it can vary according to the available profit. But the dividend can be higher than the interest paid on debentures.
Debenture holders cannot interfere in the management of the company like electing directors or removing them.	Shareholders have the right to appoint and remove directors.
Unless the debentures are perpetual the same can be repaid by the company.	Shares cannot be repaid except in a winding up or on reduction of shares by sanction of court.
In a winding up the debenture holders have preferential right over the shareholders.	In a winding up, the shareholders have only a residual interest only and if there is no asset left after payment of creditors, they get nothing.

Trustee for Debenture Holder

Under the Act, any public company wishing to issue debentures to publicshall get approval of the Securities Board of Nepal and a debenture trustee or trustees are to be appointed to look after the interest of the debenture-holders by entering into an agreement with the company. Their duties, responsibility will be covered later in this study material.

Security Interest

Any person borrowing money is often obliged to provide some security for the repayment of their loan. Almost debentures issued by a company would invariably be secured by a charge on the assets of the company. Floating charge is a peculiar charge practicable only in the case of Companies andbody corporates. The granting of security by a Company is subject to the law relating to corporate capacity and directors 'duties.

Since the company form itself has evolved during the centuries in England out of commercial necessity, the legal nature of security of the assets of the Companies also has evolved over the centuries modified by judge made law and legislation.

A security interest can be defined as "Security is created where a person (the creditor) to whom an obligation is owed by another (the debtor) by statute or contract, in addition to the personal promise of the debtor to discharge the obligation, obtains right exercisable against some property in which the debtor has an interest in order to enforce the discharge of the debtors' obligation to the creditors".

Security interest can be consensual or non-consensual. Consensual security arises by mortgage, the charge, pledge and the lien created by consent of the parties as a contractual obligation. Nonconsensual security arises by operation of law. The following consideration arises while examining a security interest:

(a) Whether the charge is fixed or floating.
(b) Whether interest created by the charge equitable or legal. Equitable chargee can be defeated by a *bona fide* purchaser of the asset for value.
(c) Whether the security interest possessing or non-possessing, the classic example of possessing security is the pledge as in the case of loan by banks against gold ornaments.
(d) What type of "propriety interest" is vested on the charge by the charge? This has a direct bearing on remedies. Even though 'charge' or 'mortgage' are used interchangeably but technically are different. 'A mortgage involves a conveyance of property as security for the loan' whereas 'charge' conveys nothing and mainly gives the chargee certain rights over the property as security for loan.
(e) The Security Interest may be created by the act of the parties or by operation of law.

In England and India, a charge will have to be registered with ROC and the date of registration will ensure its priority. But in Nepal, no such provision of registration of charge of asset in favor of debenture-holders is provided in the Companies Act. Earlier in 2021 Act, there was a provision to take permission from ROC for taking loans.

Floating Charges

This is peculiar to a corporate body. Floating charge was not recognized in Nepal until the Companies Act of 2053. Banks only recognized mortgage of properties as security for loan. Nepal Industrial Development Corporation was the first institution to recognize floating charge while granting loans to industries and at the initiation of NIDC only the recognition for floating charge was introduced and the Banking law was amended empowering banks to give series of loans on *pari passu* basis or on scale of priority basis on the same property.

A mortgage or charge by a company which contains the three following characteristics is a floating charge:
(a) It should be charge upon a class of assets both present and future.
(b) The class of assets charged must be one which in the ordinary course of business of the company would be changing from time to time.
(c) It should be contemplated by the charge that until some step is taken by the mortgagee, the company shall have the right to use the assets comprised in the charge in the ordinary course of its business.

Raising of Loans or Issuing of Debentures (Sec. 34)

(1) The Company may, if it deems necessary to raise loans or issue debentures, raise loans or issue debentures with or without mortgage or lien of immovable property of the company, after deciding the reason thereof, the plans to be executed from the proceeds, and determining necessary budget required for the same. However, a public company cannot raise loans or issue debentures until the certificate for commencement of business is obtained.
(2) Notwithstanding anything contained in any other existing Nepal laws, the company may, subject to the provisions of sub-section (1), obtain further loans or raise debenture on the security of the same property, which has already been given as security to other creditors, up

to the limit of the value of such security, clearly showing the amount due to the previous creditors and their rights (over the property).

(3) If the loans are to be raised or debentures are to be issued according to sub-section (1) or (2), the company shall inform the same to the Office and the mortgage document shall be registered according to the prevailing laws.

(4) Notwithstanding anything contained in any other existing laws, the terms, period of loan and interest rate of loans obtained or provided by the company shall be as per the document or agreement agreed upon between the creditors and the debtors.

(5) If loans are to be raised or debentures are to be issued by establishing a trustee, matters relating to the creditors and the debtors shall be according to the agreement between such trustee and the company.

Share or Debenture can be sold or mortgaged (Sec. 42)

(1) Shares or debentures of the company can be sold or given as security as movable property subject to the provisions of this Act, the memorandum of association and the articles of association.

(2) Notwithstanding anything contained in sub-section (1), the promoters of the company cannot sell or give as security (for any loan), the shares taken up by them until the first annual general Meeting is concluded and the called amounts in respect of the shares issued in their names are paid up.

(3) If shares or debentures are pledged in accordance with sub-section (1), for the purpose of noting the same in the register book, the person taking as security shall submit an application in the prescribed form together with specified fee to the registered office of the company. Along with such application, the applicant shall enclose a copy of the deed relating to the creation of the security and the certificates of shares or debentures.

(4) The company shall, on receipt of application according to sub-section (3), record the fact of such creation of security over the share or debenture in the Register book and on receipt of notice of redemption of shares or debentures on release of such security, shall cancel the record of security from the Register book.

In the 2053 Act, having a debenture trustee was optional but now 2063 Act makes it compulsory and the issue, management and supervision of debentures as a form of commercial securities is shifted to the Securities Board of Nepal under the Securities Act. Debentures issued by a public company to the public should be applied for registration with Securities Board of Nepal and any transaction by a public company or any security trader in unregistered securities is made an offense under the Securities Act, 2063. Under the 2053 Act, the company has to inform the OCR and file the mortgage documents with ROC. Now such requirement is not there except filing with the OCR the list of debenture holders along with the list of shareholders annually under sec.51. Now OCR has no role in a company raising loans and issuing debentures, except receiving and filing the List of debenture holders filed by the company annually.

Provision of Debenture Trustee for Raising of Loans or Debentures

Sec.34 of the Act makes provision for raising of loans and debentures. Even though debenture is used for raising loans, it is of different kind from loans with regard to transferability and raising

the money. The section allows only the public companies to issue debentures. But in other countries, it is usual for the Banks while giving loans even to private companies to secure by debenture so that they can transfer or sell the loan to raise further funds for themselves. But issue of debentures is controlled by the Securities Board of Nepal by its own regulations. But the section provides that a public Company considering it necessary to raise loans or debentures, may issue debentures after determining the reasons there for, as well as the plan of work to be implemented through such loans or debentures, and the budget needed for that purpose, with or without pledging any immovable asset of the Company as security or collateral. Usually loans are taken from banks who will examine the proposal for loan in detail and only after being satisfied will grant loans. Similarly Securities Board of Nepal also only after it is satisfied with the issue will give permission. However, a public Company may not raise loans or debentures until it obtains permission to commence its business and its issued capital is fully paid-up.

The Company may, raise additional loans or debentures against the same security that it has pledged to the previous creditors to the extent of the value of such security, explicitly mentioning the previous creditors and the amount. Matters relating to the conditions on which the Company has provided or obtained loans, the time-limit for redemption, and interest shall be according to the bond or agreement signed between the creditor and the borrower.

In case loans or debentures are to be raised according to Section 34, the Company must inform the OCR accordingly along with the reasons for doing so. But in practice it is not possible and is not done, since the Securities Board of Nepal is entrusted with the power to give permission for issuing debentures.

Procedures of Raising Debentures (Sec. 35)

(1) A public Company issuing debentures under this Act can issue debentures only after arranging for a debenture-trustee. The terms of the agreement between the company and the trustee will govern the relations between the creditors and the borrower (the company) regarding their respective rights and obligations. A debenture trustee is defined as "the corporate body which takes the responsibility for the protection of the interest of debenture holders when a company wants to issue debentures". Thus a debenture trustee must be a corporate body and not individuals or partnership.

(2) In case provisions regarding conversion of debentures into shares have been made in the Memorandum or Articles of Association, or in case a condition to that effect has been mentioned before issuing the debentures, the debentures may be converted into shares subject to the provisions of this Act concerning share capital, subject to the availability of the share capital that is, if necessary, the authorized capital and issued capital will have to be increased to accommodate the conversion. The terms of conversion must be explicitly mentioned in the prospectus issuing the debentures.

(3) Notwithstanding anything contained in current law, the court may, if it so deems necessary to ensure the performance of the contract signed between a public Company and any person in relation to purchasing the debentures issued by the Company, issue an order for its performance as contained in the terms of the issue.

Agreement to be Signed Between Debenture-Trustee & Company (Sec. 36)

An agreement must be signed between the debenture-issuing Company and the debenture-trustee functioning as a trustee to protect the interests of the debenture-holders in relation to the debentures to be issued by the Company. A trust deed is made under which some of them are appointed as trustees. Properties of the company are mortgaged or charged to the trustee in favor of the debenture-holders. The deed also contains provisions defining the rights of the debenture-holders and the company. The advantage of this arrangement is that it becomes the function of the trustees to watch the interest of debenture-holders. They are bound to act with the same degree of honesty, care and diligence as is required of all trustees. Any clause in the trust deed which exempts them from liability for breach of their duty as trustees or whichindemnifies them against liability is void [A debenture trustee is not an officer of the company and, therefore, he is not entitled to relief under S. 633 against any apprehended proceedings for negligence, breach of trust etc. *Central Bank Executor & Trustee Co Ltd v Magna Hard Temp Ltd*, (1977) 89 Comp Cas 40 AP]. Another advantage is that if and when the company makes a default, they can take action for enforcing the security on behalf of the debenture-holders.

The right of debenture-holder were examined by SUJATA MANOHAR J of the Bombay High Court in *Narotamdas T. Toprani v Bombay Dyeing & Mfg Co Ltd* [(1986) 3 Comp LJ 179 Bom]. A company proposed to issue a new series of debentures. Of the company‘s present debentures 96% were held by institutions, which permitted the new series; of the remaining 4% which were held by individuals, one questioned the validity of the proposal and wanted the Bombay High Court to stay it till he was able to examine the ratio between the assets and liabilities of the company. The company refused to permit him such access to its assets and stock registers.

The High Court agreed with the company in holding that he had no right to go beyond the declared accounts and allowed the company to go ahead with its debenture-issue subject only to this that if the aggrieved shareholder wanted payment, he should be paid out in cash. The court asserted that it can examine the motive of a petitioner like the present so as to see whether he is really concerned with the interests of the debenture-holders or has something up his sleeves. The court pointed out that the right of a debenture-holder of inspecting the company‘s records is extremely limited. Under Section 118 of the Indian Companies Act he can inspect the debenture-trust deed and obtain a copy of it. Under Section 163 of Indian Companies Act he can inspect and obtain copies of the register of members and of debenture - holders, annual reports and copies of certificates and documents annexed thereto. He may also have the right to copies of annual accounts. But he does not have the right of detailed inspection of the record and registers and books of account and no adverse inference can be drawn if the company does not permit it.

Such agreement must explicitly mention the following matters:

(a) Authority of the debenture-trustee to valuate the assets or analyze the project or management of theCompany.
(b) Time of payment of the principal and interest on the debenture purchased by the debenture-holders, the rate of interest, the procedure of paying the principal and interest, and matters concerning the provision, if any, made for converting the debentures into shares.

(c) Matters concerning the provision made in respect to other creditors' interest in, and future obligations on, the Company's assets.
(d) The power of the debenture-trustee to take possession of the Company's assets or property or the collateral obtained by him as security, or retain the collateral with himself or sell them by auctionor other appropriate means, in case it becomes necessary to take the financial transactions of the Company under control or possess the security mentioned in the agreement in the event of violation or non- fulfillment of the terms of the agreement or for any other appropriate reason.
(e) Matters concerning the procedure to be adopted by the Company to pay the debenture-trustee's service charge and other direct expenses.
(f) Debenture-trustee not to be liable for any loss or harm suffered by the Company or debenture-holders while functioning as such.
(g) Legal proceedings that the debenture-trustee may initiate on behalf of the debenture-holders the rights of the debenture-holders that the debenture-trustee may exercise in the event of the emergence of a situation requiring the liquidation of the Company.
(h) Other necessary matters concerning the protection of the interests of debenture-holders.

For the purpose of protecting the interests of debenture-holders, the debenture- trustee may hold the assets of the Company as a security, and have such security passed in its name according to current law.

The debenture-trustee may, if it so deems necessary before acquiring any asset or property of the Company as a security, value the concerned asset or property and analyze the Company's project or management, either personally or through others.

In case the Company decides to raise additional debentures after concluding an agreement with the debenture-trustee under this Section, the Company must seek the approval of the debenture-trustee for the same.

Power of Debenture Trustee to Conduct Inquiries and Demand Particulars (Sec. 37)

A debenture-trustee may, before signing an agreement with a Company to work in that capacity, conduct inquiries and investigations into and obtain or demand particulars, statements or information concerning the following matters. The concerned Company must make the same available if any such demand is made.

(a) Whether or not the Memorandum or Articles of Association of the Company provides for raising loans or debentures, and if such provisions exist, whether or not the Board of Directors of the Company is authorized to take a decision on raising debentures.
(b) Whether or not the Memorandum or Articles of Association of the Company provides for raising debentures through a debenture-trustee.
(c) Whether or not the current assets of the Company can cover the value of the debentures to be raised.
(d) Matters concerning the other creditors and obligations of the Company.
(e) Balance sheet and auditor's report of the Company.
(f) Other necessary matters deemed appropriate by the debenture-trustee.

Sec. 36 governs the rights of trustee after the agreement is signed and he takes up office as a trustee. But this section gives the right to a proposed trustee before he enters into office as a trustee and signs the agreement.

Company to Submit Periodic Reports toDebenture Trustee (Sec. 38)

(1) After the conclusions of an agreement between the Company and the debenture-trustee under Section 36, the Company must submit to the debenture trustee a statement of its financial transactions every six months.
(2) In case any change is effected in the management or ownership of the Company after debentures have been raised, the Company must furnish information thereof to the debenture-trustee within seven days after the change.
(3) In case the debenture-trustee needs any additional particulars, statements or information on any subject besides those furnished by the Company under Sub- Section (1) or (2), the debenturetrustee may demand the same from the Company. It shall be the duty of the Company to furnish to the debenture trustee any statement, particulars, or information so demanded by the debenture trustee.

Powers and Obligations of Debenture Trustee (Sec. 39)

(1) In case the Company violates any of the conditions mentioned in the agreement signed under Section 36, the debenture-trustee may ask the Company to fulfill the condition forthwith, or demand the repayment of the principal and interest due to the debenture-holders by prescribing a time-limit for doing so.
(2) In case it becomes necessary to take over the financial transactions of the Company or take possession of the security mentioned in the agreement owing to the repayment demanded under Sub-Section (1), or for any other appropriate reason, the debenture-trustee may, subject to current law, take the assets, property or securities of the Company under its possession, and keep them with itself or sell them by auction or otherwise, or make any other appropriate arrangement for them.
(3) After taking possession of the assets of the Company under Sub-Section (2), the debenture-trustee shall use the proceeds of the sale thereof to pay amounts due to the debenture-holders, and refund to the Company the surplus, if any.
(4) Notwithstanding anything contained elsewhere in this Act, the proceeds of the sale of the assets pledged to the debenture-trustee as security or any other assets taken under its possession by the debenture-trustee are found to be insufficient to fully repay the amount due to the debenture holders, the debenture-trustee shall make payments to the debenture-holders on a proportionate basis and the shortfall need not be recovered from the private property of the trustee. But in case the debenture trustee himself purchases the asset taken by him as security, the shortfall shall be borne from the property of the debenture trustee.

    A debenture holder holding more than fifty percent of the debentures can file an application with the Securities Board for removing the debenture trustee on the ground that he is not able to discharge his duties towards the interest of the debentureholders. On examination of the complaint, if the Board is satisfied that the claim is reasonable, then the Board can remove the trustees and make arrangement for another trustee.

Debenture Trustee to Have Rights of Debenture Holders

In case the debenture-raising Company is dissolved or becomes insolvent for any other reason, the debenture-trustee shall represent the debenture-holders in the winding up proceedings.

In case it becomes necessary to file a lawsuit on behalf of the debenture-holders in order to ensure the repayment of the principal and interest due to the debenture-holders, or for any other reason, the debenture-trustee shall have the right to do so on behalf of the debenture-holders.

Debentures represented by the debenture certificate is moveable property capable of being sold or pledged or mortgaged just like shares, subject to the provisions of the Act, Memorandum of Association and Articles of Association of the company. Amy person pledging or mortgaging his debenture should inform the company about the pledge or mortgage along with the document evidencing the pledge or mortgage. The name of the mortgagee or pledgee will be entered in the register and on receiving notice of release of pledge or mortgage shall also be entered removing the name of the pledgee or mortgagee.

Sale and Transfer of Debentures

The seller should submit an application with transfer document duly signed by the purchaser for effecting any transfer of the debentures along with the related debenture certificates. If under the any law, if any person‘s right to the debentures were established and notified to the company the company shall not be prevented from entering such person‘s name as the holder of the related debentures. The company can refuse any application for transfer if the necessary transfer fee is not paid or the transfer is not according to the document of sale and such refusal should be notified to the concerned parties within 15 days of the receipt of the application for transfer. If on the death of the debenture holder or the insolvency of the debenture holder, any person claims rights over the debentures according to prevailing law, then his name may be entered as the holder of the debentures. If such successor executes a transfer then also the transfer can be effected directly without the successor‘s name being entered in the register first.

The company has to maintain a Register of debenture holders containing the following information

(a) Full name and address of the debentureholder.
(b) No. of debentures taken by the debentureholder.
(c) The amount paid and the amount to be paid on the debentures by the debentureholder.
(d) The date on which the name of the debenture holder entered in the register.
(e) The date on which the name of the debenture holder was cancelled/removed from the register.
(f) Name and address of any nominee appointed to have rights after the death of the holder.

The above register is subject to inspection by the debenture holders and the shareholders. Other features of maintaining the registers, keeping it open and appointment of depository registrar are similar to that of shares.

14 PUBLICITY, ACCOUNTS, AUDIT & TRANSPARENCY

On the basis that "forewarned is forearmed" the fundamental principle underlying the Companies Acts has been that of disclosure. If the public and the shareholders were enabled to find out all relevant information about the company, this, thought the founding fathers of company law, would be a sure shield. The shield may not have proved quite as strong as they had expected. This publicity is mainlysecured

(a) by official notification in the Nepal Gazette;
(b) by provisions for registration at the office of the Company Registrar;
(c) by compulsory maintenance of various registers and the like by the company; and
(d) by compulsory disclosure of the financial position in the company's annual published accounts and by attempting to ensure their accuracy through a professional audit.

Accounts

A staggering transformation occurred in the course of the twentieth century in the ambit of statutory provisions regarding company accounts, as will be apparent to anyone who compares the exiguous provisions in the 2007 Act with the provision of sections and Schedules in the Companies Act 2053 as amended, supplemented and rearranged by the 2063 Act. This has resulted from the recognition:

(a) That the price of limited liability ought to be the maximum possible disclosure of information regarding the company's financial position.
One will be able to add:
(b) That quantitative, historical, financial data needs to be supplemented with forward- looking, qualitative, relational data, if the strengths and weaknesses of the company are to be fully understood.

Accounting Records

The Act starts with a prescription of a company's obligation to maintain current accounting records; and logically enough, because, although these are not open to inspection by shareholders or the public, unless they are kept it will be impossible for the company to produce verifiable annual accounts. Hence, Sec.108(2) provides that every company shall keep records sufficient to show and explain the company's transactions, to disclose with reasonable accuracy at any time its financial position and to enable its directors to ensure that any balance sheet and profit and loss account will comply with the provisions of Sec.108(2).

Section 108 requires every company to keep at its registered office proper of books of account. The first important obligation is to maintain books containing the following disclosures:

(a) All sums of money received and expended by the company and the matter in respect of which the receipt and expenditure has taken place;
(b) All sales and purchase of goods by the company;
(c) All assets and liabilities of the company;
(d) In the case of a company engaged in production, processing, manufacturing or mining activities, particulars relating to utilization of material or labour or other items of cost as may be prescribed by the Central Government.

The company should maintain such books of account as are necessary to exhibit and explain the transactions and financial position of the business of the company, including books containing entries made from day to day, in sufficient detail, of all cash received and cash paid. Were the business of the company involves dealings in goods, the records should contain statements of the annual stocktaking. Where the dealings are not by way of retailing of goods, a record should be maintained of all goods sold and purchased showing the goods, and the buyers and sellers of such goods in such sufficient details as to enable those goods and those buyers and sellers to be identified.

Sec. 108(1) provides that the accounts of company shall be kept in Nepali or English language and conform to Double entry system of accounting and to the prescribed accounting standards and the provisions in the Act.

The accounts shall be kept at the Registered Office of the company. But with the permission of OCR, the same can be kept at other places. But it is normally understood that the accounts will be kept at the place of transactions. Sometimes the Registered Office may be the address of the promoter provided at the time of incorporation and the actual establishment of the company and transactions may be at a different place altogether. If such is the case, the company should amend its registered office to conform to the present premises or take permission from OCR to keep the accounts at such place other than the registered office. It is also provided that all transactions of the Company shall be done through bank by depositing all amounts into bank account except up to the amount as prescribed by the Board of Directors for meeting cash payments in the course of the business.

The responsibility for keeping accounts is placed on the Board of Directors and other officers. According to Sec. 108(6), if the provisions relating to the preparation of annual financial statements are not complied with as laid down in the Act, then the persons who were in office as directors or other officers while preparing such annual financial statements and other report shall be responsible according to this Act. They will be liable for punishment under Sec.160 (m) for fine from Rs 20,000 to 50, 000 or imprisonment of up to 2 years or both.

Publicity of Accounts and Reports

The statutory requirement to produce accounts would be of little use, if there were no provisions for the information so generated to reach the hands of those who might make use of it. The Act contains four relevant provisions on the dissemination of the accounts. First, Sec. 77(3) provides that at least twenty one days prior to the holding of the annual general meeting, every public company shall make arrangement so that the shareholders can inspect and obtain copies of the annual financial statement, directors' report and auditors' report as referred to in Section 84 and publish a notice in a national daily newspapers for information there of.

Secondly, Sec.77 (5) entitles any shareholder to be furnished, on demand without charge, with a copy of the latest annual financial statement, directors' report and auditor's report in addition to the entitlement under Sec. 77(3). In short, Sec. 79 provides that at least twenty one days prior to the holding of the annual general meeting, every public company shall prepare the annual financial statements, directors report, auditor's report to be discussed in the meeting, the report

prepared under Section 78 and the resolutions to be presented in the meeting and arrange to so keep the same at its registered office that the shareholders can inspect them; and if any shareholder makes an application for a copy thereof, a copy thereof shall be provided to him/her. However, the resolutions to be presented in the meeting as special resolution shall be sent, along with a notice of the meeting, at the address of the shareholder.

Thirdly, under Sec. 77(1) the statutory accounts must be laid before the company in general meeting (unless the company is a private one which has elected to dispense with this requirement under its articles). Fourthly, and probably most important, copies of the annual accounts and reports have to be delivered to the Office of Company Registrar under Sec. 80, which is open for inspection or obtaining copies of the same by any person.

In the case of listed companies the Listing Rules require something a little more speedy: Accounts to be published within six months of the year end and, even more important, a preliminary announcement of the annual results (containing all the crucial financial results such as profit or loss and proposed dividends) to be given to the market within 120 days (approximately four months) of the year end.

True and Fair View

Accounts must give a true a fair view of the state of affairs of the company. 'A balance sheet must not be a mere inventory. It is supposed to be a pictorial representation of the trading position of the company. To determine whether a statement is false, its effect upon an ordinary investor should be the test.Thus where loans given to an embryonic firm were described as 'other deposits', the accounts were held to be false [*Legal Remembrancer, Bengal v Akhil Bandhu Guha,* ILR (1937) 1 Cal 328] That proper books of account shall not be deemed to be kept if there are not kept such books as are necessary to give a true and fair view of the state of affairs of the company and if they are not kept on accrual basis according to the double entry system of accounting.

Directors' fiduciary obligations would compel them to make full and frank disclosures so as to help those who are entitled to use the company's accounts for guidance in their decision making. The mode and manner of disclosure must be such as would show the reality of the financial position and working results of the company. Disclosures should be clear and unambiguous and in accordance with fundamental accounting assumptions and the commonly accepted accounting policies.

It has been held under the EEC directives that the requirement of true and fair view was ensured by taking account of all elements (i.e. profits made, liabilities and losses incurred, charges, income) which actually related to the financial year in question. [*Tomberger v Gebruder Vonder Wettern GmbH,* (1996) 2 BCLC 457 ECJ]

Even though the Act mentions about the annual financial statements to be prepared in relation to the concerned financial years, the Act does not define the financial year. This can be any twelve months or a period less or more than 12 months in particular circumstances. But since the Income tax Act has defined the financial year from Srawan 1st of the year to the end of Ashadh

of next year, almost all the companies maintain accounts based on this financial year. But company which are subsidiaries of foreign companies prepare accounts for the period corresponding to the financial year of the holding company duly audited to facilitate consolidation with the accounts of the holding company and to conform to the legal provisions in the country in which the head office issituated.

Form and content of annual financial statements

As per section 109(1) of Companies Act 2063, the annual financial statements of a company comprise of following statements:

(a) Balance sheet as at the last date of the financial year.
(b) Profit & loss account of the financial year
(c) Cash flow statement of the financial year.

Section 109(1) imposes on the directors of a public company every year at least thirty days prior to the holding of its annual general meeting, and in the case of a private company, within six months of the expiry of its financial year the duty to prepare for each financial year of the company a balance sheet and a profit and loss account and cash flow statements on an annual basis. In the case of a company not carrying on business for profit, an income and expenditure account shall be laid before the company at its annual general meeting instead of a Profit and Loss Account. The Act has very little to say about the form and contents of the company accounts.

Accounting to Comply with Accounting Standards

Section 108(2) states that the accounts to be maintained under Sub-section (1) shall be maintained according to the double entry system of accounting and in consonance with the accounting standards enforced by the competent body under the prevailing law and with such other terms and provisions required to be observed pursuant to this Act, in such a manner as to clearly reflect the actual affairs of the Company. It is further provided that if there is any deviation from the prescribed standards, the annual accounts shall state:

(a) The fact that there has been a deviation;
(b) The reason for such deviation; and
(c) The financial implication of the deviation.

It is further provided that for the purpose of this section 'accounting standards' means such accounting standards enforced by the Institute of Chartered Accountants of Nepal as may be developed by the Accounting Standards Board under Nepal Chartered Accountants Act, 2053.

The preparation of annual financial statements comprising of Balance Sheet, Profit & Loss Account and Cash Flow Statement is the responsibility of the directors. In the case of public company, the statements shall be ready at least 21 days before the date of holding the annual general meeting so that the same can be circulated to the shareholders of the annual general meeting. Except as otherwise provided in this Act, every company shall submit a copy of the annual financial statement certified by the auditor to the OCR within 6 months of the completion of its financial year Sec. 80(2). The annual financial statements should be approved bythe Board

of Directors signed on behalf of the Board by the Chairman of the meeting and at least one director [Sec.109 (7)]. This is at variance with the Indian Act, Sec. 215 (i) (ii) of which requires the accounts to be signed by its manager orsecretary, if any, and not less than two directors of the company one of whom shall be a managing director where there is one. Sec. 215(3) further provides that the Balance Sheet and Profit &Loss Account shall be approved by the Board of Directors before they are signed on behalf of the Board and before they are submitted to the auditors for their report thereon. Further the Companies Act of Nepal does not provide for a situation where the Chairman dies or is not available to sign the accounts after the Board meeting approving the accounts. These annual financial statements shall be audited [Sec. 109(3)].

Sec. 84 makes a provision to send abridged financial statements instead of the full audited annual financial statements accounts with all the annexures and not to send the directors report to the shareholders ahead of the annual general meeting in the case of listed companies.A listed company is not bound to send the annual financial statements and directors report to each shareholder, but can send an abridged financial statement as provided in sec. 84(2) & (3).

The abridged financial statements shall contain the following information: [Sec. 84(3)]

(a) A statement that the abridged financial statements is only an abstract of the annual financial statements and the directors report.
(b) Opinion of the company‘s auditor that the abstract annual financial statements are in accordance with the (audited) annual financial statements and the directorsreport.
(c) Whether or not the abridged financial statements are drawn in the format specified for the purpose.
(d) Whether the auditor has made any comments about the annual financial statements.
(e) If any comments have been made by the auditor then full details of such comments and other necessary matters to understand the comments matters.
(f) If the auditor has made the following comments:
    (i) The accounts of the company and the particulars relating to the accounts are incomplete
    (ii) The accounts do not agree with the records and particulars
    (iii) The explanations and information demanded have not been furnished then full particulars of the same.

The abridged financial statements are to be prepared in the format prescribed by OCR on the recommendation of the Accounting Standards Board. But no format seems to have been notified so far. The abridged financial statements, instead of being sent to the address of the individual shareholders, may be published twice in a national daily level newspaper while publishing the notice calling the meeting to consider the accounts. If the abridged financial statements are published twice in the national level newspapers, it is not necessary to send the same to the individual shareholders.

The company is punishable *per se*, that is, by the mere fact of default. Thus, where a company in default was acquitted on the ground that the circumstances were beyond its control, but the directors were convicted, the acquittal of the company was quashed. [*Asst Registrar of Companies v Sudarsan Liner Ltd*, (1988) 63 Comp Cas 747 Mad.]

It has been held [*Tota Ram v Emperor*, AIR 1916 Lah 397: 34 IC 962] that it would be no defence for a failure to file accounts that the directors were not legally qualified under the articles of association to act as directors as they had no shares at all in the company or the requisite number of shares to qualify them as directors. A person who acts as a director cannot set up in answer to a penalty that he was not legally a director. He cannot protect himself from liability by saying "I am not a director *dejure*". Similarly, it is no defence that the account books were seized by the police in connection with a criminal case [*Great India Steam Navigation Co v State*, (1967) 37 Comp. Cas 135 Cal] or that they were lying in a court. [*Ramchandra & Sons (P) Ltd. v State*, (1967) 2 Comp LJ 92. A director was held to be not entitled to an automatic or mechanical relief for default under the section though his induction into the company was for the limited purpose of the performance of an export contract of the company. *Shiv Kumar Dalmia v Mangal Chand Hukum Chand*, (1996) 86 Comp Cas 366: (1996) 2 Comp LJ 219 MP. *Shree Hanuman Steel Rolling Mills v Asst ROC*, (1996) 2 Cal LJ 64, books of account seized by an investigating agency, failure to submit annual accounts not willful, prosecution not warranted. *Amia Chadha v ROC*, (1998) 74 Del LT 537, dispute about access of books].

Further, when there is no chairman of the Board of Directors or the Chairman is absent at the meeting, there is no provision for that. Since Chairman's function is merely to conduct the meetings, each meeting can choose its own chairman. Here the chairman of the meeting which approved the accounts should sign and not the chairman of the Board. Hence in Indian Act, there is no provision for the accounts to be signed by the chairman of the meeting, even though normally the chairman signs the accounts.

The directors, in addition, should prepare a report for each financial year. This must contain a fair review of the development of the business of the company and of its subsidiaries, where they have subsidiaries, during the financial year and the position at the end of it, must state what amount (if any) they recommend should be paid as dividend and what amount (if any) they propose to carry to reserves. If the approved accounts do not comply with the Act and give wrong information, every director, every officer(which will include the auditor also) who was involved in the preparation of and who was a party to their approval and who knows that they do not comply with the Act or is reckless as to whether or not they comply is guilty of an offence under Sec.109(9) and Sec. 160 (a) & (b) liable to a fine from Rs 20,000 to Rs.50,000/- or imprisonment up to two years or both. Every director at the time the accounts were approved is taken to be a party to their approval unless he shows that he took all reasonable steps to prevent their approval.

Sec. 109(4) of Companies Act requires the board of directors of every public company or every private company having paid up share capital of Rs. one crore ormore or every private company having an annual turnover of Rs. ten crore ormore to prepare, in addition to the annual financial statements, director report dealing with the following matters:

(a) A review of the business during the previous year.
Whether there has been improvement in production and sale of the goods or services, whether profit made or loss incurred, whether it is an improvement over the earlier year or not and if so reasons may be dealt with.

(b) Impact, if any, of the national and international situation upon the business of the Company.

Whether any political upheaval in any country or impending war or warlike situation, terrorist activities or other favorable situation like any new trade treaty entered into with any country, easing of tensions, opening up of new areas of trade etc. may be dealt with.

(c) Achievements of the current year as of the date of preparation of the report, and opinion of the Board of Directors on future actions.
Whether the performance has been better or worse, than the year under report from the close of the financial year to the date of preparation of report and opinion of the Board on the performance in the remaining period of the current year and prospects of the current year.

(d) Industrial or professional relations of the Company.
This will cover general industrial situation in the country and relationship with other competitor industries and industries who are suppliers and customers of the company and relationship with the employees

(e) Change made in the Board of Directors, and reasons therefore.
Any casual vacancy in the board, their filling up, and reasons for the casual vacancy and the justification for the new appointee.

(f) Main factors affecting thebusiness.
Any special factors affecting the business like increase in duties and taxes, availability of power and fuel, availability of raw material, restriction on markets etc.

(g) Board of Directors' reaction to remarks made, if any, in the audit report.
If the auditor has given any suggestions for improvement or has given any adverse comments regarding the operation of the company, then the board reaction to the said comment should be provided

(h) The amount recommended for distribution as dividend.

(i) Number of shares forfeited, if any, face value of such shares, total amount received by the Company in consideration of such shares before their forfeiture, the amount received by the Company by selling such shares after their forfeiture, and particulars of the amount refunded, if any, in consideration of the forfeited shares.

(j) Progress made in the business of the Company and its subsidiary company during the previous Financial Year, and a review of the situation as of the last day of that Financial Year.

(k) Main transactions carried out by the Company and its subsidiary Company during the Financial Year and any important change in the business of the Company during the period.

(l) Information furnished to the Company by its basic shareholders during the previous Financial Year.

(m) Particulars of the ownership of shares taken up by the Directors and office- bearers of the Company during the previous Financial Year, and information received by the Company from them about their involvement, if any, in the transactions of the shares of the Company.

(n) Particulars of information furnished by any Director or any of his close relatives about his personal interest in any agreement connected with the Company signed during the previous Financial Year.

(o) In case the Company has purchased its own shares, the reason there for, the number and face value of such shares, and the amount paid by the Company for the purpose.

(p) Whether or not there is an internal control system, and if there is any such system, details there of.

It is the duty of the auditors to point out in their report any deficiency found in the internal control system of the company which creates a risk that may cause loss to the company and the directors should comment or give their opinion as to the finding of the auditors in that behalf. In the case of a public company the auditor's report will have to be submitted to the audit committee, who will have to express their comments and reactions to the report.

(q) Particulars of the total management expenses of the previous Financial Year.
The Act has not defined "management expenses' for the purpose of this section. Whether it denotes only the salary and perquisites given to the management staff or does it refer to the total administrative expenses of the company other than direct expenses incurred in the production of the goods or providing the services is not clear. The total administrative expenses are always furnished with the Profit and loss account and so there is no necessity to repeat the same again.

(r) A list of members of the Audit Committee, remuneration, allowances and facilities being received by them, particulars of functions discharged by the Committee, and particulars of suggestions, if any, offered by the Committee.

(s) Payments due, if any, to the Company from any Director, Managing Director, Executive Chief, or basic shareholders of the Company or any of their close relatives, or from any firm, Company or corporate body in which he is involved.

(t) Amounts paid as remuneration, allowances and facilities to the Directors, the Managing Director, the Executive Chief and otheroffice-bearers.

(u) Dividends yet to be collected by shareholders.
This will refer to the dividends declared and paid in the past years but not collected by the shareholders, may be due to change of address.

(v) Any other matter to be mentioned in the Board of Directors' report under this Act and current law.
If any special resolution is proposed to be passed, the nature and effect of such resolution on the total operation of the company and the necessity for passing such resolution.

(w) Other necessary matters.
This may relate to any pending claims against the company or any legal proceedings by or against the company pending in court or arbitration and the possible contingent loss on any such claim etc.

Accrual Basis

According to the guidance notes [guidance Note on Accrual Basis of Accounting] there are two basic features of this system of accounting. First, revenue means revenue earned, whether received in cash for the time being or not; second, costs are incurred when they become payable whether actually paid or not. How these methods are to be applied by an enterprise constitutes its accounting policy namely, a method of accounting which reflects the truth so that those for whose information the accounts are meant are able to get a fair view of things. Hence, what is more important is the substance of the financial position of the company and not the forms and formats through which that substance is presented as a true and fair view. Forms and formats are only for guidance. That is why latitude is given to follow as nearly as may be possible under the circumstances of a particular enterprise, with only this obligation that any significant departure from the prescribed method under accounting policy should be disclosed. Disclosures of

accounting policy in reference to some items are also required. They are: policy regarding mode of valuation of stock and basis of valuation of investments.

Preservation of Books of Accounts

Sec. 109(8) provides that the accounts and financial statements prepared under this section shall be preserved at least for five years from the end of the financial years to which they relate. The company should have a policy in order to preserve the account books.

Audit

The statutory accounts discussed above are the responsibility of the directors. However, all modern company law systems have long accepted the principle that the reliability of the accounts will be increased if there is in place a system of independent third party verification of the accounts. The temptation to present the accounts in a light which is unduly favorable to the management is one likely to afflict all boards of directors at one or another time and the temptation is likely to be at its strongest when the financial condition of the company is at its weakest and shareholders, creditors and investors are most in need of access to the truth. To provide such third-party verification is the traditional role of the audit.

The final document that has to accompany the annual report is the auditor's report thereon. Every company should appoint auditor according to the Act to audit the accounts. In case there are foreign branches, the auditor so appointed can audit the accounts of those branches also unless the laws of the country in which the branch is situated provide otherwise.

Generally the auditors of a company are appointed at its annual general meeting. An auditor at one annual general meeting holds office from the conclusion of that meeting until the conclusion of the next annual general meeting. His appointment should be intimated within 15 days of the appointment to OCR.

At an annual general meeting, a retiring auditor is re-appointed, except in the following cases:

(a) When he is not qualified forre-appointment;
(b) When he has given to the company notice in writing of his unwillingness to be re-appointed;
(c) A resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
(d) Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor and by reason of the death, incapacity or disqualification of that person the resolution cannot be proceeded with.

Where at any such meeting no auditor is appointed or reappointed, OCR shall be informed of the fact because the OCR, in such a case, gets the right to appoint an auditor to fill the vacancy at recommendation of the BOD of the company.

The first auditors in the lives of companies are appointed by the company‘s board within one month of incorporation and they hold office until the first annual general meeting. If the board fails to do so, the company may in general meeting make an appointment.

In the case of private company, the auditor shall be appointed as provided in the Memorandum of Association, Articles of Association or unanimous agreement. In case it is not so provided, the auditor shall be appointed at the annual general meeting.

The first auditors are appointed by the Company's Board of Directors to hold office till the first annual general meeting.

If by inadvertence, auditor is omitted to be appointed at the general meeting or the annual general meeting itself could not be held or if the auditor appointed could not continue for any reason, on the request of the Board of directors, OCRmay appoint another auditor. But in case of single shareholder Company, the auditor shall be appointed by the single shareholder or the authorized person as provided in its AoA in writing.

In the case of public company, the same auditor cannot be appointed to audit the accounts for more than three consecutive years, including his partner or past partner or employee or past employee. If the past partner or past employee has left the auditor more than three years before, the restriction shall not apply to them.

Disqualification of Auditor

The following persons, or the firms or companies in which they are partners, may not be appointed as auditors, or remain in office if they have already been appointed in that capacity:

(a) Any Director or advisor of the Company or any person belonging to the management group of the Company, or any worker or employee of the Company, or any partner of any such person, or any employee of any of such partners, or any close relative of any of such persons, or any employee of any of such persons;
(b) Any debtor of the Company;
(c) Any person who has yet to complete three years after being punished on charges pertaining to audit.
(d) Any person who is insolvent;
(e) Any shareholder of the Company or any of the close relatives of any person holding one percent or more of the paid-up capital of the Company;
(f) Any person who has yet to complete five years after being punished on the charge of corruption, cheating or a criminal offense involving moral turpitude.
(g) Any person who has continuously audited the accounts of a public company for three financial years;
(h) In the case of a public Company, any person working in any governmental or non-governmental body or any other Company on a full or part time basis, or any of his partners or any of the persons working as employees of such partners, or any person who is authorized to sign any document or report to be prepared on behalf of the Company.
(i) Any Company or corporate body with limited liability;
(j) Any person having any interest in any transaction with the Company, or any of his close relatives, or any Director, office-bearer or basic shareholder of any other Company having any other interest in any transaction with the Company.

The auditor must, prior to his appointment, inform the Company in writing that he is not disqualified as above. In case any auditor becomes disqualified for auditing the accounts of the Company before the expiry of his term, or in case a situation emerges in which he can no longer be appointed or continue as the auditor of the Company, he must immediately stop the process of auditing the accounts being audited or to be audited by him and furnish information thereof in writing to the Company. The accounts audited by any auditor in contravention of this Section shall not be valid.

Auditor Independence

Laws for securing the independence of auditors from management have focused to date mainly on placing the appointment, remuneration and removal of auditors in the hands of the shareholders. More recently, there has been interest also in controlling the provision by auditors of non-audit work to the company and in structuring the nature of the board‘s interaction with the auditors. However, before we turn to them it is necessary to note the statutory provisions which exclude certain persons from acting as auditors on grounds of potential conflict of interest.

The need for independent audit cannot be over-emphasized. As pointed out by *Carey in his Professional Ethics of Public Accountings: "*independence is the keystone in the structure ofthe accounting profession. Clearly there would be no great store by the certified Accountant‘s opinion or certificate if they [users of his published reports] were not confident of his independence of judgment as well as his technical competence. The basic difference between privately employed accountants and professional practitioners is in their responsibilities, moral or legal, to the corporation or the public, and in the extent to which their relationship may tend to influence their judgment. In the last analysis, therefore, it is his independence which is the certified public accountant's economic excuse for existence". As the American Institute of Accountants in their Code of Auditing Standards put it: "Independence in the last analysis bespeaks an honest disinterestedness on the part of the auditor in the formulation and expression of his opinion, which means unbiased judgment and object consideration of facts as the determinants of that opinion. If the auditor is to maintain independence, he should have no financial interest whatever, direct or indirect, with the company or its management, during the period of his audit work". Cf. The U.S.A. Securities and Exchange Commission‘s Regulations, S.X. As the Commission expressed in the case of A. Hollander & Sons Inc. [Release 2777 (1941)], "Independence tends to assure the objective and impartial consideration which is needed for the fair solution of the complex and often controversial matters that arise in the ordinary course of audit work. On the other hand, bias due to the pressure of an entangling affiliation or interest, inconsistent with the professional relations of accountant and client, may cause loss of objectivity and impartiality and tends to cast doubt upon the reliability and fairness of the accountant's opinion".

In actual practice, an auditor will be considered independent only if he avoids any relationship which might arouse the suspicion that such relationship had prevented an impartial attitude of mind. An auditor should not only be free from impropriety but also from the appearance of it. *Readings in Auditing* edited by *Johnson and Brasseaux* (1960), page 136.

But independence does not mean that the auditor should assume an attitude of hostility and proceed like a prosecutor. It only points to the need for his functioning in a fair and impartial manner with a sense of obligation not only to the management and those immediately concerned or interested in the company's business but also to those prospectively interested to become shareholders or creditors.

Both the code of ethics adopted by the American Institute of Accountants and the regulations of the Securities and Exchange Commission enjoin that for securing the independence of the auditor, the appointment of relatives of the promoter, underwriter, voting trustee, director, officer or employees should be avoided.

In an illuminating article on the ethics of the profession of accountants, published in the Accountants 'Journal' of the Philippines (re-produced at page 303, 1978 November issue of Chartered Accountant Official Organ of the Institute of Chartered Accountants of India), Mr. Lus P. Vera, Chairman of the Board of Accountancy and President and Director of several corporations in the Philippines, observes as follows:

(a) "A CPA (Certified Public Accountant) or firm engaged by a client to audit his books of account shall not serve the same client for the same period in any other capacity whatsoever. Therefore a CPA or firm who is engaged as external auditor may not render management advisory service, or tax service, transfer agency service etc. for the same client for the same fiscal year".

(b) "External auditors who serve the same client in a dual capacity are open to the suspicion, as well as to the temptation that the other service impairs his objectivity. While it is possible that this may not actually be the case, the fact that the auditor's independence becomes suspect is enough reason for the profession to see to it that such a situation is avoided".

(c) "A CPA should be forbidden from accepting an engagement as an independent auditor of a company in which a relative of his has a substantial interest or is a director, voting trustee or officer, as these situations invariably give rise to a suspicion on the part of the general public that the auditor's independence is likely to be impaired there by".

Independence of Auditor

A person is in eligible for appointment on the ground of lack of independence if he is an officer or employee of the company or a partner or employee of such an officer or employee or, in the case of the appointment of partnership, if any member of the partnership is ineligible on these grounds. And he is also ineligible if any of these grounds apply in relation to any associated undertaking of the company. Clearly, an employer-employee relationship is far from being the only type of relationship which might impair the independence of the auditors, e.g. a debtor-creditor relationship or a substantial shareholding in the company might do so. The recent European Commission Recommendation indicates some situations where the power could be used, for example, to impose a 'cooling off' period in respect of staff moving from the auditor to the company or vice versa.

Sec. 112 (1) (a), (c), (e) provide for the above. In addition to that to ensure independence Sec. 111(3) further provides that the same auditor or his partner cannot be auditor for a public company for more than three years.

The copy of auditor report has to be made available to the shareholders by the company. Normally, the copy of auditors report is attached to the financial statements which are to be circulated to shareholders. Apart from that, if there is a recognized authorized trade union, at the written request of such trade union, the company should provide a copy of the report to the Trade Union also.

Power & Duties

Every auditor has the right of access to the books and accounts and vouchers of the company. He may require from the officers of the company any information he thinks necessary for the performance of his duties.

The auditor has to submit a report on the accounts of the company to the shareholders of the company. The scheme of the Act is that the directors must prepare the accounts; the auditor must make a report to the shareholders on the accounts; the report must contain statements on certain specified matters. [PENNYCUICK J in Thomas Gerard & Son Ltd, Re, (1967) 2 All ER 525: (1967) 3 WLR 84] The report should state whether the accounts are kept in accordance with the provisions of the Act and whether they give a true and fair view of the state of affairs of the company.

Indian company laws makes the duty of the auditor to inquire into the following matters:

(a) Whether the loans and advances made by the company on the basis of security have been properly secured and whether the terms are not prejudicial to the interest of the company or its members;
(b) Whether the book-entry transactions are not prejudicial to the interests of the company;
(c) Where, the company is not an investment, or a banking company, whether any securities have been sold by the company at a price less than that at which they were purchased;
(d) Whether loans and advances made by the company have been shown as deposits;
(e) Whether personal expenses have been charged to revenue account;
(f) Whether cash has actually been received in respect of any shares shown in the books to have been allotted for cash if no cash has been received, whether the position as stated in the books is correct, regular and not misleading.

Sub-section (3) of Sec. 115 requires the auditor‘s report to state:

(a) Whether, he has obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purposes of his audit;
(b) Whether, in his opinion, proper books of account as required by law have been kept by the company so far as appears from his examination of those books, and proper returns adequate for the purposes of his audit have been received from branches not visited by him;
(c) Whether, the company‘s balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and returns.

(d) Whether the Board of Directors or representative or any employee has done any act in violation of any law or has misappropriated any property of the company or has caused loss to the company;
(e) Any fraud has been committed with respect to the account of the company;
(f) Recommendation, if any.

Auditor's Duty

As regards his duty generally under the companies Act, he should not merely rely on the statement of the management as regards matters which are capable of direct verification by him from books and accounts and vouchers. *Controller of Insurance v H.C. Das,* A.I.R. 1957 Cal.

An auditor is bound to verify the assets of a company himself, and he cannot rely on the verification done by persons appointed by the company itself. *Institute of Chartered Accountants v Raja ram,* (1960 30 Com. Cases 67.

In respect of any special technical matters, the auditor is entitled to consult and take the opinion of an expert: *Registrar of Companies, Bombay v. P.M. Hedge,* A.I.R. 1954 Mad. 1080.

In actual practice in almost all cases what the auditor does is that he makes a formal report adopting the bare language of the section. This is what is called in U.S.A. 'the standard short-form report' as distinguished from the long-form report which, as the name implies, will contain a more elaborate expression of opinion, with detailed explanations and qualifications where necessary. Whether short or long, the object of the report is to assure that a conscientious examination of the accounts has been made and that the judgment of a qualified person has been applied to them

Company Law Department of India's View of the Auditor's Duty

"The requirements of the Act are that the auditors should specifically certify whether the published accounts give a 'true and fair' view of the company's state of affairs and of the loss for the financial year (as compared with the requirements of certification as true and correct under the 1913 Act). Prima facie this requirement has imposed an obligation on the auditors to make observations in respect of matters which were not previously commented upon in the auditor's certificate under the Companies Act, 1913. An examination of the company accounts duly audited by the auditors, and filed by the companies discloses that there is as yet adequate realization of this obligation by a majority of the auditors. In a large number of cases, it has been observed that the auditors have given clean certificate on the company accounts audited by them without looking into matters which are clearly relevant to a 'true and fair view' of the affairs of the companies concerned. In this connection, some of the auditors have contended legalistically and on the basis of an unduly narrow interpretation of the letter of section 227 of the Act, that the certificate is required to be based only on the result of the scrutiny of the books of account maintained by a company under the provisions of section 209 of the Act, and that the auditors are not required to report to the shareholders of the company, the infringements of the provisions of the Companies Act or those of the other important laws, much less to draw their attention to inadequate provision of depreciation, to under or over valuation of current assets like stock-in-

trade, to improper allocation of reserves, to improper classification of debts and loans etc., although these defects may come to their notice in course of their carrying out the audit of the companies concerned. Such omissions are not, however, in accordance with the best traditions of audit practice and in the view of the Department of Company Law Administration it would not be a proper discharge of their responsibilities if auditors were not to disclose the above irregularities in their reports. For, it would be difficult to hold that an audit report which ignores such important matters as must necessarily have a close bearing on the fortunes of a company could give a true and fair view of its affairs. On the contrary, the clear certificates issued by auditors in such cases would tend to mislead the shareholders as well as the general public who might have to deal with the companies concerned". (Third Annual Report to Parliament on the Working of the Companies Act, 1956, Para164).

According to a press release, dated 18th June, 1962, the Department has impressed upon the chartered accountants, acting as statutory auditors of companies, through the Institute of Chartered Accountants, that it was their duty to comment on all such material violations of the law or sound accounting practice as might reasonably be expected to affect directly or indirectly the fortunes of the companies accounts.

According to the opinion expressed in *Palmer's Company Precedents,* an auditor should not be satisfied merely by vouchers, apparently formal and regular but should by fair and reasonable examination of them, see that they are not for payments in any way unauthorized or illegal or improper' (16th Edn. Page 657).

Duties of Auditors under Case Laws

"What is the proper function of an auditor? It is said that he is bound only to verify the sum, the arithmetical conclusion, by reference to the books and all necessary vouching material and oral explanations; and that it is no part of his function to inquire whether an article is covered by patents or not. I think this is too narrow a view. An auditor is not to be confined to the mechanics or checking vouchers and making arithmetical computations. His vital task is to take care to see that errors are not made be they errors of computation, or errors of omission or commission, or downright untruths. To perform this task properly, he must come to it with an inquiring mind 'not suspicious of dishonesty, I agree' but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none. I would not have it thought that Re *Kingston Cotton Mills Co.* (No.2) (1), (1896) 2 Ch 279, relieved an auditor of his responsibility for making a proper check. But the check, to be effective may require some legal knowledge, or some knowledge of patents or other specialty. What is he then to do? Take, for instance, a point of law arising in the course of auditing a company's accounts. He may come on a payment which it appears to him may be unlawful, in that it may not be within the powers of the corporation, or improper in that it may have no warrant or justification. He is then, not only entitled but bound to inquire into it and, if need be, to disallow it: see *Roberts v. Hopwood,* [*1925 A.C.* 578 at 605]; Re: *Ridsdel; Ridsdel v. Rowlinson* [(1947) 2 All E.R. 312 at 316]. It may be, of course, that he has sufficient legal knowledge to deal with it himself, as many accountants have, but, if it is beyond him, he is entitled to take legal advice on the principle stated in *Bevan v. Webbb,* [(1901) 2 Ch. 59 at p. 75], that, permission to a man to do an act which he cannot do

effectually without the help of an agent, carries with it the right to employ an agent," *Foments Ltd. v. Selsdon Ltd.,* [(1958) I All E.R. 11 at 23(H.L.)].

The position with reference to the previous decisions is thus summarized in Lord Simonds'edition of Halsbury's Laws of England: "It is the duty of an auditor to verify not merely the arithmetical accuracy of the balance sheet, but its substantial accuracy, to see that it includes the particulars required by the articles and by statute, and contains a correct representation of the state of the company's affairs. While, therefore, it is not his duty to consider whether the business prudently conducted, he is bound to consider and report to the shareholders whether the balance sheet shows the true financial position of the company. To do this he must examine the books and take reasonable care to see that their contents are substantially accurate. Except in special cases, he should place before the shareholders the necessary information as to the true financial position of the company, and not merely indicate the means of acquiring it. Apart from his statutory duty, which cannot be removed by the articles or an agreement, the exact duties of an auditor are regulated by the contract under which he is employed. The statutory duty is not absolute but depends upon the explanations furnished and information given; but an auditor must ask for information on matters which call for further explanation. An auditor must take steps to learn his statutory duties and his duties under the articles. It is his duty to consider whether payments made by the company before the audit were authorized by the articles, and he will be liable for improper payments made by the directors and, naturally, resulting from his breach of duty. So an auditor who reports confidentially to the directors the insufficiency of the securities on which the capital is invested and the difficulty of realization, but who only reports to the shareholders that the value depends on realization, with the result that the shareholders ignorantly approve an improper dividend, is liable to make good the amount paid. An auditor should not be content with a certificate that securities are in the possession of any person or body of persons, however trustworthy, unless the certificate is given by a bank or other person who in the ordinary course of business would usually be entrusted with securities". *Halsbury's Laws of England, 3rd Edn.* Vol. VI, page 387. The case-Law is also elaborately discussed in re *City Equitable Fire Insurance Co.,* [1925 Ch.407].

Explaining the position of auditors CHAKRAVARTI CJ of the Calcutta High Court said: "A joint stock company carries on business with capital furnished by persons who buy its shares. The owners of the capital are, however, not in direct control of its application which is left to the executive of the company. In those circumstances, some arrangements is obviously called for by which those who provide the capital know periodically what is being done with their money, how the affairs of the company stand and what the present value of their investment is. The Companies Act, therefore, provides for the employment of an auditor who is the servant of the shareholders and whose duty is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found. That examination by an independent agency such as the auditor is practically the only safeguard which the shareholders have against the enterprise being carried on in a businesslike way or their money being misapplied or misappropriated without their knowing anything about it. The Act provides the safeguard in two forms. It makes the duty of the auditor to give an expression of opinion on certain specified matters of a vital character and it makes him liable, along with the directors, for misfeasance, if he fails to perform his duties as required by law and the approved audit procedure".

Thus, the auditors owe a number of duties to the company and its shareholders. The fore most among them is to check the accuracy of accounts. But his duty is not to confine himself merely to the task of verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy, and to ascertain that it was properly drawn up, so as to contain a true and correct representation of the state of the company's affairs. [See, STIRLING J in Leeds Estate Co v Shepherd, (1887) 36 Ch D 787, 802] They should not act merely as mechanical adder-uppers and subtractors [See, L DENNING in *Fomento (Sterling Area) Ltd v Selsdon Fountain Pen Co,* (1958) 1 All ER 11, 23] Thus, where an auditor of a banking company failed to verify the cash balance claimed by the management and the actual cash in hand turned out to be much less than what was shown in the books, he was held guilty of neglect of duty [*Dy Secretary v S.N. Das Gupta,* (1955) 25 Comp. Cas 413: AIR 1956 Cal 414: 60 Cal WN 124] The Court said: "A certificate from the management can obviously be no substitute for such verification. The whole object of an audit is an examination of what the management has done and if the statements of the very persons who constitute the management were to be accepted in all matters, even in matters capable of direct verification, an audit would be an idle farce". [Quoting ROMER J in *City Equitable Fire Ins Co. Re, I (1924)* All ER Rep 485: 133 LT 520: (1925) Ch 407481].

But in certain matters of technical nature, for example, valuation of stock-in-trade, the auditor will have to rely on some skilled person. Accordingly, an auditor could not be guilty of breach of duty when, in the absence of suspicious circumstances, he relied for this purpose on the manager of a cotton mill. [*Kingston Cotton Mill Co, Re,* (1896) 2 Ch 279 : 74 LT 568, see the judgment of LINDLEY LJ at pp 286-87, *Cited Thomas Gerrard & Sons Ltd*, Re, (1967) 2 All eR 525: (1967) 3 WLR 84]

Where the accountants assisted the directors in connection with the preparation of a circular for rights issue, they were held not liable to shareholders for statements made to the directors in respect of profit forecast. [*Abbott v Strong,* (1998) 2 BCLC 420 Ch D] An action against auditors for negligence could not succeed though the investor relied on the audited accounts and also on informal discussions with the auditors. There was insufficient evidence to show that the accountants had assumed any duty towards the particular investor.

It has become common place to quote a figure of speech employed by Lopes' L. J., in re *Kingston Cotton Mills Co.*, (1896) 2 Ch. 288, and say that "the auditor is only a watch-dog and not a bloodhound, which, casting the metaphor aside, means that his duty is verification and not detection. But does not verification extended to being vigilant? Is not the watch-dog bound to bark and chase too where necessary? If when sniffing round, you hit upon a trail of something wrong, surely you must follow it up and there is just as much obligation on the auditor, who is bound to keep his eyes open, and his nose too. It may be that by vigilantly following this trail up to the end, he may 'root up' something from which fraud is exposed". Cf. the judgment of Lord Justice Holmes in the *Irish Woolen Co.v. Tyson* reported in [(1900) 26 ALR 15]. The Accountant Law Reports, page13.

In somewhat similar way, Donovan J., observed in a Canadian case that though the auditor may be only a watch-dog he will not have performed the functions of his office, if, after one howl, he

retreats under the barn or if he confines his protest to a fellow watch-dog, *International Laboratories Ltd. v. Dewar,* (1933) 1 D.L.R. 34.

As Lord Alverstone pointed out in *London Oil Storage Company Ltd., v. Seear Hasluck and Co.* (referred by in Dicksee's book on Auditing), it is the duty of the auditor, where suspicion is aroused, to probe the thing to the bottom. *Institute of Chartered Accountants of India v. P. K. Mukherjee,* (1968) 38 Com. Cases, 628 P: (1968) 2 Com. L.J. 211 (S.C.).

The scope and true purpose of an audit and the duties of the auditor are also discussed in a decision of the Madras High Court in *Registrar of Companies v. Arunajatai,* (1962) 32 Com. Cases 1153: (1963) 1 Comp. L.J. 323 where it is pointed out that where there was material before the auditor to arouse suspicion, he should have at least appraised of it in his report to the shareholders,

It has been held by the British House of Lords in *Hedley Bryne & Co. Ltd. v. Heller and Partners Ltd.,* [(1964 A.C. 465: (1964) 1 Comp. L. J. 14] that a person exercising any profession or calling will be liable for negligence resulting in failure to exercise due care and skill, to any person relying upon his careless advice or information, despite the absence of contractual relationship with him, unless when giving such advice or information, he expressly disclaims any personal responsibility therefore. See also *Arsen v. Casson Beckman Rutely and Co.* (1975) 3 All E. R. 901 where the House of Lords has held that there is no immunity from third party liability in the case of an accountant or any other person except where he acts judicially.

While the auditor undoubtedly comes within this rule, there is no reason why his liability should extend to outsiders other than the shareholders to whom alone he makes his report, though it may be that to the extent of the duty of care owed by him to the shareholder, any dissatisfied shareholders may pursue a claim against the auditor in his own right.

Shortly stated, the position is that so long as the auditor acts honestly, and without negligence and adheres to generally accepted auditing standards and follows generally recognized normal auditing procedures, he will not be held responsible for any defalcation, fraud or irregularity, which, in spite of following such procedures, he has not discovered. As stated by *de Paula*, it is very unlikely that an auditor will be held personally liable if he is possessed of the requisite professional skill and exercises such skill honestly taking care to satisfy himself on every point before he certificates the accounts, *de Paula Principles of Auditing 12th Edn. Page 245*. An auditor's position will indeed be intolerable, if he is to be made liable for not tracking out ingenious and planned schemes of fraud, when there is nothing to arouse suspicion.

As regards the standard of duty of auditors it has been held in an English case, Re *Thomas Gerrard and Sons Ltd.,* [(1967) 2 All E. R. 525: (1967)] 2 Comp. L. J. 197] that the standards of reasonable care and skill are on the expert evidence more exacting today than those which prevailed in 1896', when the *Kingston Cotton Mill Co.,* case was decided. It is based on the following general proposition contained in the hand-book issued by the Council of the Institute of Chartered Accountants of England andWales: "It is the duty of the auditor of a company to arrive at an independent professional opinion on whether the directors have properly carried out their own duties in the preparation of accounts and their presentation to shareholders and

according to the expert evidence, in cases where there is no sound system of internal auditing, it is the duty of the auditor to make deeper and more extensive tests".

Though it is not his duty to take stock, it is certainly incumbent upon him when any alteration or other manipulation affecting the valuation comes to his notice, to take all reasonable steps to verify that the supporting vouchers and other documents relating there to are in order.

According to the same decision, where the directors do not allot sufficient time to make such investigations as are necessary for a proper audit, the auditor must either refuse to make a report at all, or make an appropriately qualified report. He will not be justified in making a report containing a statement the truth of which he has not had an opportunity of ascertaining.

Auditor's General Liability

The general liability of an auditor, or for that matter, of a member of any other skilled and learned profession is thus described in *Cooley on Torts:* "In all those employments where peculiar skill is requisite, if one offers his services, he is understood as holding himself out to the public as possessing the degree of skill commonly possessed by others in the same employment, and if his pretensions are unfounded, he commits a species of fraud upon every man who employ him in reliance on his public profession. But no man, whether skilled or unskilled undertakes that the task he assumes shall be performed successfully, and without fault or error; he undertakes for good faith and integrity, but not for infallibility and he is liable to his employer for negligence, bad faith or dishonesty, but not for losses consequent upon mere errors of judgment". So far as the company which has appointed him as auditor is concerned, he will be liable ifhe does not perform his duty properly or is guilty of gross negligence or fraud. But he also owes a legal responsibility to third parties who might have been misled by his audit certificate and acted in reliance thereon. "A representation certified as true to the knowledge of the accountant when knowledge there is none, a reckless misstatement or an opinion based on grounds so flimsy as to lead to the conclusion that there was no genuine belief in its truth, are all sufficient upon which to base liability. A refusal to see the obvious, a failure to investigate the doubtful, if sufficiently gross may furnish evidence leading to an inference of fraud so as to impose liability for losses suffered by those who rely on the balance sheet". *State Street Trust Co. v. Ernst [*15 N.E. wd 41,] following *Ultramares Co. v. Touche,* [225 N.Y. 170.] Under the Securities Exchange Act of U.S.A. an auditor is made liable to third parties not only for fraud but also for negligent mis-representation, even if it be innocent. (*Accountant's Handbook, 4th Edition, section 28,* page 31).

Ordinarily, an auditor is liable to make good the loss or damage resulting from negligence on his part, such as failure to detect defalcations or discover errors which may have caused loss to the company, and this liability may extend also to third parties such as bankers, creditors, etc., who, by reason of their relying upon the audited statements or accounts have suffered loss or damage. In a recent case, Bank of Scotland vs. Bannerman, it was held that the auditor having known that his accounts will be presented to the bank is liable to bank for negligence in certifying the Balance Sheet, even though he was not engaged by the Bank to do the audit.

Defining the Liability Rules

The leading case on the application of these rules to auditors is undoubtedly the decision of the House of Lords in *Caparo Industries Plc v Dickman* [(1990) 2 A.C. 605, HL] and, as a result of its unanimous decision, the ambit of the duty of care owed by auditors has been somewhat clarified so far as English law is concerned. The statutory provisions establish a relationship between those responsible for the accounts (the directors) or for the report (the auditors) and some other class or classes of persons and this relationship imposes a duty of care owed to those persons. Among these 'persons' is the company itself, to which, apart altogether from the statutory provisions, the directors are in a fiduciary relationship and the auditors in a contractual relationship by virtue of their employment by the company as its auditors.

The statutory provisions do not establish such a relationship with everybody who has a right to be furnished with copies of the accounts or report or, *a fortiori*, with everybody who has a right to inspect, or obtain, copies of them. If a relationship other than with the company is to be established under the statutory provisions, it can be only with members (and perhaps debenture-holders) and, even in their case, the scope of the resulting duty of care extends only to the protection of what, for the moment, may be described as those persons'corporate powers to safeguard their interests in the company.

Standard of Care and Skill

It has always been the law that an auditor must exercise reasonable care and skill in the discharge of his duty. [Electra private equity partners v KPMG Peat Marwick [(1998): PNLR 135] Referring to this duty ROMER J said in City Equitable Fire Insurance Co.Re:

"He must be honest, i.e. he must not certify what he does not believe to be true and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient. Where suspicion is aroused more care is obviously necessary; but, still an auditor is not bound to exercise more than reasonable care and skill even in a case of suspicion and he is perfectly justified in acting on the opinion of an expert where special knowledge is required". In another case LOPES LJ said: "He (the auditor), is a watch dog, but not a bloodhound". [*Kingston Cotton Mill Co.* Re, (1896) 2 Ch 279, 288:74 LT568] "He is not an insurer". [ROMER Jin *City Equitable Fire Insurance Co,* Re (1924) All ER Rep 485: 133 LT 520: (1925) Ch 407 at p481]

If the company owns securities the auditor should see that they are in proper custody. He should not be content with a certificate that securities are in the possession of a particular company, firm or person unless the company, etc., is trustworthy, or is respectable and further is one that in the ordinary course of business keeps securities for its customers. Thus, where the stockbrokers of a company certified to it auditors that they were holding the company's securities, when in fact they did not do so and the company suffered loss, the auditors were held guilty of negligence. They should have at once set the matter right or reported it to the shareholders. [*City Equitable Fire Insurance Co.* Re, (1924) All ER Re 485: 133 LT 520: (1925) Ch 407, but the auditors were protected from liability under special provisions of the company' articles] Similarly, in a case before the Calcutta High Court. [*Ganesan v A. K. Joscelyne,* AIR 1957 Cal 33: (1957) 27 Comp.

Cas 114]. The auditor of a company found that the accounts presented by the directors showed that selling agency commission was paid to the managing agents in addition to their remuneration, but was not included in remuneration, nor was it shown as an item of expenditure, but was deducted from the sale proceeds of the goods sold by them.

CHAKRAVARTI CJ held that the auditor ought to have required the directors to explain why the selling agency commission was not included in remuneration and whether a special resolution had been passed to authorize the payment of a separate commission. "His failure to ask for such information betrays negligence in the performance of his duties".

An auditor is, however, not concerned with the policy of the company. In the words of LINDLEYLJ: [*Londo & Genera lBank, (No.2), IRe,* (1895)2Ch673, 682:73LT304:(1895-99) All ER]. It is no part of the auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is being conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain and state the true financial position of the company at the time of the audit.

On the facts of the case, however, the auditor was held guilty of breach of duty. He presented a confidential report to the directors calling their attention to the insufficiency of the securities on which the capital of the company was invested, and the difficulty of realizing them. But his report to the shareholders merely stated that the value of the assets was dependent on realization. As a result the shareholders were deceived as to the condition of the company and a dividend was declared out of the capital and not out of income. It was held that the auditor was guilty of misfeasance and was liable to make good the amount of dividend paid. But his liability does not end here. He would also be liable for the costs of recovering the extra tax, if any, which has been paid on the basis of the false accounts and also for any of the extra tax which is not recoverable. [*Thomas Gerrard & Son Ltd*, Re, (1967) 3 WLR 84: 2 All ER525]

Standard of Care and Caution

Establishment of a duty of care is, of course, only part of a negligence claim. It must also be shown that the duty is, of course, broken (which requires consideration of the standard of care required) and that the breach caused the claimant's loss.

As far as the standard of care is concerned, it is clear in law, though often not accepted in the commercial world, that the audit is not a guarantor of the accuracy of the directors 'accounts.

Indeed, in an old case the auditor was given a broad discretion to rely on information provided by management, so long as no suspicious circumstances arise which should put the auditor on inquiry. However, the force of this proposition depends in consideration part on how willing the courts are to find that no circumstances had arisen which were suspicious, and there is some evidence that modern courts take a more demanding line than their predecessors. [Re *Thomas Gerrard & Son Ltd (1967)* 2 All E.R. 525, where the discovery of altered invoices, it was held,

should have caused the auditors to carry out their own check on the stock.] Moreover, some dicta suggest that, even in the absence of suspicious circumstances, modern auditing standards might require auditors to do more of their own motion. As Lord Denning once put it, the auditor, in order to perform his task properly, –must come to it with an inquiring mind– not suspicious of dishonesty, I agree- but suspecting that someone may have made a mistake somewhere and that a check must be made to ensure that there has been none‖. [*Formento (Sterling Area) Ltd. v. Selsdom Fountain Pen Co. Ltd* (1958) 1 W.L.R. 45,HL.

Duty to Company and to Third Parties

The traditional concept of auditors 'duty has been that they owe their duty to the company and the company only. This concept was fortified by the judgment of CARDOZO CJ in *uCorpn v Touche:* [(1931) 255 NY Rep 170: Reported in Thurston and Seavy, CASES ON TORTS, (1942) 757 and cited in *Candler v Crane, Christmas & Co.* (1951) 2 KB 164: (1951) 1 All ER 426]. The defendants, a firm of public accountants, were employed by a company to prepare and certify a balance sheet of the company. The company, to the knowledge of the accountants, had borrowed large sums of money from banks and other lenders. They also knew that their certified balance sheet would be exhibited to other lenders to induce them to lend money. Accordingly, when the balance sheet was made up, it was shown to the plaintiffs, who, acting on the faith of it, lent and lost huge sums of money.

The court found that there was evidence of negligence by the defendants in making their report but held that this would not make them liable to the plaintiffs. CARDOZO CJ said: "The defendants owed to their employer a duty imposed by law to make their certificate without fraud, and a duty growing out of contract to make it with the care and caution proper to their calling. Fraud includes pretense of knowledge when knowledge there is none. To creditors and investors to whom the employer exhibited the certificates, the defendants owed a like duty to make it without fraud. A different question develops when we ask whether they owed a duty to them to make it without negligence. Its liability for negligence exists, a thoughtless slip or blunder, the failure to detect a theft or forgery beneath the cover of deceptive entries, may expose accountants to a liability in an indeterminate amount for an indeterminate time to an indeterminate class".

It means that nothing less than a fraudulent report will make an auditor liable to an outsider who has been deceived by it. Fraud must be proved in the terms of its definition as laid down by LORD HERSCHELL in *Derry v Peek.* [(1889) 14 App Ca 337] A negligent misstatement is not the same thing as fraud. This has been pointed out by the court of appeal in *Candler v Crane, Christmas & Co.* [(1951) 2 KB 164: (1951) 1 All ER 426]. The plaintiff, who desired to invest £2000 in a limited liability company, was put in touch with the company's accountants by the manager. The accountants knew that the plaintiff was a potential investor. They prepared and showed the accounts to the plaintiff and also talked with him. The plaintiff invested his money in the company. The accounts were carelessly prepared, contained numerous false statements and gave a wholly misleading picture of the state of the company, which was wound up within a year, the plaintiff losing the whole of his investment.

Even so it was held by a majority that the accountants were not liable to the plaintiff. Their Lordships said that a false statement, carelessly, as contrasted with fraudulently, made by one

person to another, though acted on by that other to his detriment, was not actionable in the absence of any contractual or fiduciary relationship between the parties. DENNING LJ in his dissenting opinion observed: "I think that the law would fail to serve the best interests of the community if it should hold that accountants and auditors owe a duty to no one but their client. The accountant, who certifies the accounts of his client, is always called on to express his personal opinion as to whether the accounts exhibit a true and correct view of his client's affairs; and he is required to do this, not so much for the satisfaction of his own client, but more for the guidance of shareholders, investors, revenue authorities, and others who have to rely on the accounts in serious matters of business. (Yet) the persons who are misled cannot complain because the accountants owe no duty to them. If such be the law, I think it is to be regretted, for it means that the accountant's certificate, which should be a safeguard, becomes a snare for those who rely on it. In my opinion accountants owe a duty of care not only to their clients, but also to those whom they know will rely on their accounts in the transactions for which those accounts are prepared".

The decision in *Candler v Crane, Christmas & Co* has been overruled by the House of Lords in Hedley Byrne & Co v Heller & Partners Ltd: [(1963) 3 WLR 101: (1963) 2 All ER 575: 1964 AC 465]. Here a firm of advertising agents had lost a huge sum of money by placing advertising orders for a company. They asked their bankers to inquire into the company's financial stability and their bankers made inquiries of the respondents, who were the company's bankers. The respondents gave favorable reference but stipulated that these were 'without responsibility'. In reliance on those references the appellants placed orders which resulted in the loss.

The bankers would have been held liable but for the express disclaimer of responsibility. Lord MORRIS explained the principle thus: "I consider that it should now be considered as settled that if someone possessed of a special skill undertakes, quite irrespective of contract, to apply his skill for the assistance of another person who relies upon such skill, a duty of care will arise. Further more, if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make a careful inquiry or a person takes upon himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise".

There is a wind of change in the United States also. For example, it was observed in *Texas Tunnelling Co v City of Chattanooga,* [204 F Supp 821 (E.D. Tenn 1962), reversed in 329 F 2d 402 (6thcir 1964). Borrowed from 1966 JBL 190] "that there have been significant changes in the American society during the thirty years that have elapsed since the decision in *Ultramares case.* The continued growth and expansion of industry, the growth of population, the urbanization of society, the growing complexity of business relations and the growing specialization of business functions all require more and more reliance in business transactions upon the representation of specialists".

The principle of the *Hedley Byrne case* has been followed by the Canadian Court in *Haig v Bamford* [(1972) 32 DLR (3d) 67 Sask. B. noted, Current Law, June, 1973] where an auditor, who issued a certificate without verification, was held liable to a person who was misled by the

certificate. A similar liability has been imposed upon an auditor who participated in the negotiations for the sale of company's shares on the basis of the balance sheet audited and certified by him. The value thus determined turned out to be unreal because the balance sheet was not satisfactory. The court emphasized that if the auditor had not participated in the negotiations, the result would have been different.

Where an auditor is appointed to check the accounts of the Employees'Provident Fund maintained by a company, he owes his duty not merely to the company, but also to the beneficiaries of the fund and will be responsible to them for professional misconduct if he fails to report that the trustees have allowed irregular loans to the company out of the fund. [*Institute of Chartered Accountants of India v P.K. Mukherjee*, (1968) 2 Comp LJ 211] If this were not so, the accountants and auditors could as well say: "You may inspect the accounts of X Company Ltd, but do not expect these documents to have been prepared with any degree of skill or care". "It is our view that the auditor or accountant owes a duty of care to the investor, creditor, and others to prepare proper audits or accounts".

A Civil Aviation Authority was refusing to renew the air travel company's license due to unsatisfactory financial position unless certain confirmations were given by the auditors in their final report as to the finances of the company. The auditors submitted the requisite information to the Authority. The company collapsed. The accounts were negligently prepared. The Authority's claim against the auditors was allowed as they had assumed responsibility towards the Authority for exercising due care and caution in preparing the company's accounts. [*Andrew v Kounnis Freeman*, (1999) 2 BCLC 641CA]

Defining the Liability Rules

The leading case on the application of these rules to auditors is undoubtedly the decision of the House of Lords in *Caparo Industries Plc v Dickman* [(1990) 2 A.C. 605, HL. The preliminary issue on which *Caparo* reached the House of Lords was whether, on the facts pleaded, a claim against the auditors could succeed. Two directors were also being sued for alleged fraud] and, as a result of its unanimous decision, the ambit of the duty of care owed by auditors has been somewhat clarified so far as English law is concerned. The statutory provisions establish a relationship between those responsible for the accounts (the directors) or for the report (the auditors) and some other class or classes of persons and this relationship imposes a duty of care owed to those persons. Among these 'persons' is the company itself, to which, apart altogether from the statutory provisions, the directors are in a fiduciary relationship and the auditors in a contractual relationship by virtue of their employment by the company as its auditors.

The statutory provisions do not establish such a relationship with everybody who has a right to be furnished with copies of the accounts or report or, a *fortiori*, with everybody who has a right to inspect, or obtain, copies of them. If a relationship other than with the company is to be established under the statutory provisions, it can be only with members (and perhaps debenture-holders) and, even in their case, the scope of the resulting duty of care extends only to the protection of what, for the moment, may be described as those persons'corporate powers to safeguard their interests in the company.

The case-law after *Capora*has concentrated on seeking to determine the basis or bases upon which it will be possible for claimants to establish a 'special relationship' or, as it is now often called in the light of subsequent general developments in the law of negligence,'an assumption of responsibility' on the part of the auditors towards the claimant. A crucial initial issue is that the special relationship does not require that the auditor should consciously have assumed responsibility. The auditors will be treated as knowing both what they actually knew and that which a reasonable person in their position would know. A number of different situations have been considered in this light in the case law. First, within groups of companies, the courts have accepted that it is arguable that the auditors of a subsidiary company owe a duty of care to the parent company, since the auditors will be aware that the parent will rely on the audit of the subsidiary to produce accounts which reflect a true and fair view of the group as a whole.

A second area of tortuous duty to 'third' parties involves the directors of the company by which the auditors have been engaged. Although the Act prescribes the compilation of the accounts by the directors and their audit as consecutive and separate events, in practice the two overlap, with the directors finalizing the accounts at the same time as the audit is in progress on the basis of draft accounts. The directors are not obliged to accept the auditors'views but are entitled to be informed before they commit themselves, with the risk that their approach may lead to the accounts being qualified by the auditors.

However, the most obvious strategy suggested by the *Caparo* decision for investors in or lenders to the company (or, sometimes, its regulator), who do in fact propose to rely on the company's accounts, is to seek to make the auditors aware in advance of the transaction of their intentions and to secure from the auditors an *ad hoc* assumption of responsibility for the accounts in relation to the contemplated transaction.

Duty in Connection With Takeover

A three point formula has been propounded by the Court of Appeal in England on the auditor's duty to the investing public. The court said that in determining the auditor's duty of care those relying on accounts audited by him, it must be shown that:

(a) It was foreseeable that the persons relying on the accounts would suffer harm if the auditor was negligent;
(b) The auditor and the user of the accounts stood in a relationship of sufficient proximity;
(c) The circumstances made it just and reasonable to impose such a duty on the auditor.

One company was taking over another company. It relied upon the company's audited accounts and suffered loss because there was a negligent inaccuracy in the accounts. The plaintiff company was a shareholder of the other company and was also a potential investor. The court readily conceded that it was foreseeable that the shareholders of the company would suffer economic loss if the auditors were negligent in the matter of the company's accounts. Since they stand between the company and the shareholders and make their report to the shareholders, they owe a responsibility to the individual shareholders so as to put the auditors under a duty of care towards them and there was nothing to make it unfair or unreasonable to impose a duty of care on the auditors towards the investing shareholders of the company, but that there was no such

duty towards the non-shareholders who relied on audited accounts to buy the shares of the company undertake over.

Stressing this point again in a subsequent case, HOFFMAN J said: [*Morgan Crucible Co plc v Hill Samuel Bank Ltd*, (1990) 3 All ER 331 Ch D]. The directors and financial advisers of the target company in a contested takeover bid owe no duty of care to a known takeover bidder regarding the accuracy of profit forecasts, financial statements and defense documents prepared for the purpose of contesting the bid since the reason such documents are prepared is to advise the shareholders of the target company whether to accept the bid and they are not meant for the guidance of bidders. Accordingly, there does not exist sufficient proximity between the directors and financial advisers of the target company and the bidder to give rise to a duty of care.

It was therefore, held that the defendants did not owe any duty of care to the plaintiff to ensure that pre-bid financial statements and the profit forecast were accurate. At the time that the plaintiff announced the takeover bid for another company, the recently published financial statements of the company were its reports and accounts for the years 1984 and 1985 which had been audited by a firm of accountants and an unaudited interim statement for six months. These statements were cited in all the circulars sent to the shareholders for their guidance. Another circular forecast a 38% increase in profits in the year up to Jan 31, 1986. This document included a letter from the accountants stating that it had been properly complied in accordance with the company‘s accounting policies and a letter from the bank expressing the opinion that the forecast had been made after due and careful inquiry. On this basis the shareholders were advised not to accept the proposed bid. The plaintiff then increased the bid – amount and the same was recommended to the shareholders and accepted by them. Subsequently it was discovered that the accounting policy adopted in the pre-bid financial statement and the profit forecast were negligently misleading and had the effect of grossly overstating the profits and that the company was worthless at the time the bid was made with the result that if the plaintiff had known the true facts, it would never had made the bid, let alone increased it. But even so those who prepared the statements from the company‘s side for the guidance of its shareholders were held not liable to the plaintiff. [The court referred to *Caparo Industries plc v. Dickman, (1990* 1 All ER 568: (1990) 2 WLR 358 HL: 1990 BCLC 273]

Where the audit partner of a firm of accountants expressly vouched for a set of accounts which his firm had audited, the firm would be liable in negligence if those accounts were defective. It was a known fact that the bid would not proceed unless this undertaking that the accounts were true and fair was given.

The duty of an auditor of a subsidiary company to its holding company was explained in *Baring plc v Cooper & Lybrand*. [(1997) 1 BCLC 427 CA] The court was of the view that there is no legal principle that a holding company is not entitled to recover damages for loss in the value of its subsidiary resulting directly from a breach of duty owed to the company itself as distinct from the duty owed to the subsidiary. The auditors of the subsidiary are supposed to be aware of the fact that their duty to see the true and fair aspect of the subsidiary‘s accounts and their report on it is the only basis on which the true and fair view of all the companies in the group (consolidated group accounts) would be ensured. Thus the holding company had the direct right

of action against the subsidiary's auditors for their failure to detect a dealer's fraud. [The court followed the principle laid down in *George Fisher (Great Britain) Ltd v Multi Construction Ltd*, (1995) 1 BCLC260]

Removal of Auditor (Sec. 119)

According to Sec. 119(11), an auditor appointed to audit the accounts of financial statements, he cannot be removed until such audit work is over. In India & UK, an auditor is appointed at an annual general meeting to hold office till the conclusion of the next annual general meeting at which either he is reappointed or is replaced by some other auditor appointed. But when the audit work will be deemed to have been completed is not made clear. Is this over when he has given the final audit report addressed to the shareholder to the company or is it over at the conclusion of the next annual general meeting.

But an auditor appointed can be removed under the following circumstances [Sec. 119(2)]:

(a) If any auditor does any act in violation of the code of conduct of auditor;
(b) If any auditor does any act against the interest of the company which has appointed him/her as the auditor
(c) If the auditor does any act in violation of any law inforce;
(d) By giving prior intimation to the Institute of Chartered Accountants of Nepal;
(e) By obtaining approval of the regulating authority, if any, of the business carried on by the company (i.e. in the case of Banking and Financial Institution, from Nepal Rashtra Bank, in the case of insurance companies from the Insurance Board);
(f) If no regulatory authority is there, by taking permission of OCR.

The auditor can be removed by the same manner in which he was appointed. i.e. in the case of first auditor, remove by the Board of Directors and in the case of auditor appointed by OCR, remove by OCR and in case of appointment by general meeting by the general meeting. The third option seems impracticable, because in the case of a public company with numerous shareholders, it will be a time consuming & costly affairs and so the audit committee should be careful while recommending the auditor.

Before removing the auditor, he shall be given reasonable opportunity to provide his justification and explanation. Here, the auditor may send a written representation to the appointing authority and also provide him opportunity to be present before the appointing authority for defense.

Remuneration of Auditor

Sec. 118 provides that the person appointing the auditor shall fix the remuneration of auditor and the remuneration shall be paid by the company. In the case of first auditor, the remuneration shall be fixed by the Board of Directors, and in the case of appointment by general meeting, the general meeting shall determine. In the case of appointment by OCR, the remuneration will be fixed by OCR.

This is intended to emphasize that the auditor are the watchdogs of the shareholders rather the director's 'Lapdogs'.But in practice, it serves little purpose since the shareholders normally adopt the resolution proposed by the directors to the effect that the remuneration shall be agreed

by the directors. A more effective protection, perhaps, is that the amount of the remuneration for statutory audit work, tax audit work, and any other nature of work, expenses and benefits in kind has to be shown by way of note to the annual accounts, thus enabling the members to criticize the director if the amount seen to be out of line. This is prevalent in UK & India but omitted in Nepal. But the return to be submitted under Sec. 78 has to mention only the remuneration paid to the auditors. But it is not made clear whether it is only for statutory audit or for other services also to be included.

Audit Committee

Chapter 18 Sec. 164 provides for an audit committee to be appointed by following companies consisting of at least three members from among the directors. The following companies shall have an audit committee:

(a) A listed company with a paid up capital of Rs 3 Cores or more,
(b) Companies fully owned by the government,
(c) Companies partly owned by the government.

The chairperson of the audit committee shall be a director who is not involved in the day to day operation of the company. A close relative of the chief executive of the company shall not eligible to be a member of the audit committee.

At least one member of the committee should be an experienced person with professional qualification in accounting or a person having gained experience in accounting and financial fields after having obtained at least bachelor's degree in accounts, commerce, management, finance or economics.

(1) The report of the Board of Directors to be prepared by the Company must also explicitly mention the brief particulars of the functions and activities of the Audit Committee, the working policies adopted by the Board of Directors to implement the suggestions, if any, offered by the Audit Committee, the information about any allowance or facility provided to the members of the Audit Committee, and the names of the members of the Audit Committee.
(2) The Audit Committee may notify the Managing Director, Executive Chief or any Director involved in the operation of the routine business of the Company, or the auditor, internal auditor and Chief Accountant to attend its meeting for the purpose of enquiring into any matter or any issue, and in case a notice is so received, it shall be the duty of the concerned person to attend the meeting of the Committee.
(3) The Board of Directors shall implement the suggestions offered by the Audit Committee on matters concerning the Company's accounts and financial system, and in case the Board of Directors cannot implement any such suggestions, the same must be explicitly mentioned in the Board of Directors' report along with the reasons there for.
(4) The Company shall make arrangements for adequate means and resources needed by the Audit Committee to work according to its responsibilities. The Audit Committee shall itself regulate its internal working procedure.
(5) The Chairman of the Audit Committee shall attend the Annual General Meeting of the Company in person.

(6) Meetings of the Audit Committee shall be held according toneed

Functions, Duties and Powers of the Audit Committee (Sec. 165)

The functions, duties and powers of the Audit Committee formed under Sub-Section (1) of Section 164 shall be as follows:

(a) To review the internal financial control system and the risk management system of the Company and determined the authenticity of the matters mentioned in such statements.
(b) To review the internal financial control system and the risk management system of the Company.
(c) To supervise and review the internal audit operations of the Company.
(d) To recommend the names of potential auditors for appointment as the auditor of the Company, fix the remuneration and other terms of appointment of the auditor, and submit the same to the General Meeting forendorsement.
(e) To supervise and review whether or not the auditor of the Company has complied with the code of conduct, standards and guidelines prescribed by the body authorized to do so under current law while auditing the accounts of the Company.
(f) To finalize policies to be adopted by the Company on matters concerning the appointment and selection of auditors on the basis of the code of conduct, standards and guidelines prescribed by the body authorized to do so under current law.
(g) To prepare and enforce or make arrangements for enforcing the accounts related policies of the Company.
(h) To meet the necessary conditions to prepare the Long Form Audit Report in case any regulatory body has made a provision for the same in respect to the Company.
(i) To discharge such other functions as are prescribed by the Board of Directors with respect to the accounts, financial system and audit of the Company.

The audit committee is appointed by the Board of Directors and the committee reports to the Board of Directors only. It is the duty of the Board of directors to report activities of the committee to the general meeting through their Report under sec. 109.

It has been found that in most of the recent company failures reported, the audit committee could not function effectively, since they are appointed by the Board and their remuneration is decided by the board.

In India and UK the audit committee has not been prescribed in the statute. In India, it is provided in the listing rules for the listed companies. In UK, the audit committee is provided under the code of good governance to be observed by all listed companies and supervised by the City of London and by the Financial Reports Review Panel of Financial Reporting Council.

Calling for Explanation & Investigation

Enquiry by Registrar of Companies (Sec. 120)

In case any particulars in the documents filed by the company are not clear, and in case in respect of any matter further enquiries are to be made, OCR may write to the company to clarify them giving a period to reply for the queries. The management of the company i.e. the Board of Directors or Chief executive officer, if any, shall answer the queries within the time given in the

letter. On receipt of such clarification, if OCR finds any irregularity, OCR may issue necessary instruction to the company to rectify the irregularity and the company shall comply with such instruction. This section provides for *suo motu* Enquiry by the OCR.

Inspection at the request of shareholders

Sec.121 provides for inspection of the records of the company by appointing inspector in case an application is received complaining on work that has been done against the prevailing law or the provision in the Memorandum & Articles of Association, prospectus or unanimous agreement, from

(a) Shareholders representing at least 10% of the paid up capital or
(b) Shareholders s comprising one fourth of the total number of member of the company or
(c) an interested creditor / lender with proper reason and evidences.

In such case to make an investigation, OCR may appoint one or more inspector/s as may be found necessary. Such inspector should be an expert in accounting or law or finance or management or commerce, or industry or company management or in any one of the business conducted by the company. The inspector shall not have any kind of interest with the transactions of the concerned company. The applicant shall depositthe estimated cost of such inspection as notified by OCR.

Inspection Suo motu by OCR

If the OCR feels that any of the following conditions exist, without any complaint or application being received, on its own, OCRmay appoint an inspector qualified as above on its own, and examine the business and transaction of the company. The conditions are:

(a) If it comes to be known that during the course of the business and transaction of the company that the shareholders and the creditors have been cheatedor committed any other kind offraud or has committed illegal actor has carried out activities harming the interest of the general public.
(b) If any public company does not publish the information relating to its business that is to be furnished.

The Powers & Duties of the Inspector

The functions, duties and powers of an inspector appointed under Section 122 shall be as follows*:*

(a) To summon any current or former office-bearer or shareholder of the Company deemed appropriate by him, or any other person whom he believes to be in possession of any information connected with the matter to be investigated, and record his statement or acquire necessary information or any other reasonable cooperation from him, in the course of investigations.
(b) To inspect relevant documents, take into custody or retain any other thing, or order any concerned person to submit to him any such document or thing, or take any such document under his control for the purpose of investigations.
(c) To conduct or make arrangements for conducting an inspection to find out whether or not the accounts of the Company have been maintained properly.

Anything revealed to or any statement made before the inspector by any person in the course of investigations under this Chapter shall be acceptable as evidence against him, notwithstanding anything contained in current law.

Cooperation to be extended to Inspectors (Sec. 123)

(1) In case any person makes a false statement, or does not submit any statement, document or any other thing to be submitted under Section 122, furnish any reply to any query made by the inspector, or submit any particulars demanded by the inspector for the purpose of investigations, the inspector may file a written complaint report to the court in that connection.

(2) In case a complaint report is filed under Sub-Section (1), the court shall make necessary inquiries according to current, law, and, if it finds anybody to be guilty, subject him to a punishment deemed appropriate by it under Section162.

Report to be Submitted

The inspector appointed under the provisions of this chapter, after completion of his work should submit his report along with his recommendation to the OCR. One copy of the report should be given to the complainant, if any. If any shareholder applies for a copy of the OCR, OCR shall provide a copy after collecting the charges for the same.

OCR shall instruct the company to proceed against the following persons who's according to the report are guilty of the following on behalf of the company. Any director, managing director, manager, employee or any other officers who

(i) have knowingly caused loss to the company;
(ii) have cheated the shareholder or creditor;
(iii) have committed fraudor have committed any other illegal acts.

But this does not prevent the company or the shareholders to take any other action permitted under the law.

If OCR finds that if the business is allowed to be continued to be managed by the director, or managing director or manager or employee or other officer who are found guilty under the report, loss will be caused to the company and OCR can issue necessary instruction to suspend those office holders and to arrange to manage the business of the company in any other way.

Notwithstanding anything contained in the current law, any matter mentioned in the report of the inspector and any other fact that has been expressed in the report shall be eligible to be received as evidence in any legal action in court of law.

Payment of Inspection Expenses

(a) In case inspection is started on the complaint of shareholders or creditor, the complainant will have to pay the estimated expense;
(b) In case of *suo motu* inspection by OCR, the company will have to pay the expense;
(c) Where any director, or managing director, manager or officer is found to have acted in bad

faith or cheated or committed fraud then such director, managing director or manager or officer shall pay the expenses within 7 days of the completion of the inspection.

(d) If they do not pay, then the same will be collected from them as the government due.

The inspector also can comment and make recommendation in his report as to the mode of payment of the expenses of inspection or who should pay the expenses.

Dividends

Almost all commercial corporate enterprises are undertaken with the view of making profits for their members. The profits of a company when distributed among its shareholders are called 'dividends'. No special authority either in the memorandum or in the articles is necessary to enable a company to pay dividends. The power is implied.

Any person invests in the shares of companies to get a return on his investment. Any distribution of the company's assets could be made to shareholders by way of return of capital by a formal reduction of capital approved by the court but also when it is a redemption or purchase by the company of its shares or by the company giving financial assistance for the subscription or purchase of its shares.

But a more common type of distribution of assets to shareholders is in the form of periodical dividends. If dividends can be paid despite the fact that the value of net assets of the company is or will become, after the distribution, less than the value of issued share capital plus share premium amount (if any) plus capital redemption reserve (if any), it defeats the purpose of capital maintenance rules.

The payment of dividend is bound by two fundamental principles. The first is that dividends shall never be paid out of capital. It is supplemented by the second that dividends shall be paid only out of profits. The Act allows dividends to be paid out of the following two sources:

(a) Profits of the company for the year for which dividends are to be paid;
(b) Undistributed profits of the previous financial years.

Payment of dividends out of capital is a breach of trust and the company may require the directors to replace the capital. Thus in the well-known *Flit croft case* certain bad debts were credited to the accounts and the fictitious profits thus created were paid away as dividends. The directors were held liable. Explaining the reason JESSEL M R said: "The creditor has no debtor but that impalpable thing the corporation, which has no property except the assets of the business. The creditor, therefore, gives credit to that capital, gives credit to the company on the faith of the representation that the capital shall be applied only for the purposes of the business, and he has therefore a right to say that the corporation shall keep its capital and not return it to the shareholders".

Dividend Fund

The courts declared that dividends must not be paid out of capital. More meaningfully they declared that dividends could be paid only out of profit. As dividends can be declared only out of surplus earnings, there must be an exact method of determining whether surplus earnings for that

purposes actually exist. But the Act provides no guidance. There is nothing at all in the Act about how dividends are to be paid, nor how profits are to be reckoned; all that is left and very judiciously and properly left, to the commercial world. It is not a subject for an Act of Parliament to say how accounts are to be kept; what is to be put into a capital account, what into an income account, is left to men of business. But the concept of 'Profits' itself was riddled with confusion and in a case of litigation it has to be decided by the lawyers after hearing to what the accountants and businessmen say.

The same truth is reflected by the following observations of RAMACHANDRA AYYAR, CJ, of the Madras High Court: "Section 205 of Indian Companies Act only prescribes that dividend shall be paid out of profits of the company. It does not say further how those profits have to be ascertained. Profits of a year under the mercantile system of accounting only means the excess of receipts for the year over expenses and outgoings during the same year. It is not necessary that such excess should be in form of cash in the till of the company. It will be open to a company to declare a dividend on the basis of its accounts where it is based on the estimated profit, which had not actually come in the form of cash to the company; it will be open to it to pay such dividends from out of other cash in their hands or perhaps even to borrow and pay them off. That will not amount to paying dividend out of capital". Neither have the courts thought it fit to formulate any rigid rules. The judicial attitude is best reflected by the following observation of Lord MACNAGHTEN in *Dove v Cory.* I do not think it desirable for any tribunal to do what Parliament has abstained from doing. I.e. to formulate rules for the guidance and embarrassment of businessmen in the conduct of business affairs.

> The real question for determination, therefore, is whether there are profits available for distribution, and this is to be answered according to the circumstances of each particular case, the nature of the company, and the evidence of competence witnesses. There is nosingle definition of the word 'profits' which will fit all cases. [FARWELL J in Bond v Barrow *Hematite Steel Co.* (1902) 1 Ch 353: (1900-03) All ER Rep484]

The Courts decision prior to 1981 in England was as follows:

- So long as the properly prepared accounts of the company showed a trading profit for the accounting period, that could be distributed by way of dividend without regard to earlier year losses.
- A realized profit on the sale of fixed assets could also be, so distributed and so could unrealized profit on a revaluation of fixed assets.
- Accumulated profit of previous year could also be so distributed, provided they are not diminished by issue of bonus shares and transfer to capital redemption reserve.

The European second Company Law directive made it incumbent to tighten up the rules which laid down 'No distribution (of assets) to shareholders may be made when the net assets are or following such distribution would become, lower than the amount of the subscribed capital plus those reserves which may not be distributed under the law or the statutes'.

The 1981 English Act defined 'Profits available for the purpose' as the company's 'accumulated profits, so far as not previously utilized by distribution or capitalization loss its

accumulated, realized losses, so far as not previously written off in a reduction or reorganization of capital duly made'.

This rule postulated two fundamental changes:

(a) There must be a surplus of profit for the current and past years (so far as they are retained) over losses for those years (so far as they have not been lawfully written off);
(b) The profits must be realized, although unrealized profits could be utilized to pay up a bonus issue, they can no longer be used to pay a dividend.

The additional rule for public companies insists not on the balance between realized profits and realized losses, but on the company's net asset position once the dividend has been paid.

The law will not tolerate even an indirect attempt to pay back capital by way of dividends. Thus,

Walters'Deed of Guarantee, [(1933) Ch 321: (1933) All ER Rep 430: 148 LT 473].W guaranteed the payment of the preference dividends for a period of three years and the company agreed to pay him any sums that he might pay under theguarantee. The agreement was held to be void and W could not recover the amounts paid by him in pursuance of the guarantee.

In such cases only that part of the agreement is void by which the company contracts to indemnify the guarantor. But, apart from this, a guarantee for the payment of dividends is valid.

Here 'Net assets' of a company (i.e. Aggregate assets less aggregate of liabilities) should not fall below the value of its share capital and un-distributable reserves. Apart from the fact that the European directive requires this rule, the main impact of this rule is to be found in the definition of undistributable reserve. This will include Share premium Reserve, Capital redemption reserve, Revaluation Reserve and also these reserves which the Banks & similar institution are obliged to maintain under the Act applicable to them.

Let us see an illustration:

Balance Sheet of XY Bank Ltd.

	Rs. in Lakh		Rs. in Lakh
Share Capital	30.00	Cash and Bank	3.00
General Reserve	10.00	Loans & Advance	258.00
Revaluation Reserve	1.00	Non banking	50.00
Share premium A/c	3.00	Other Amts.	10.00
Capital Redemption Reserve	5.00	Goodwill	50.00
Debentures	20.00		
Profit & Loss Account	5.00		
Other liabilities	270.00		
Deposit	27.00		
	371.00		371.00

In the above case undistributable reserves will be as follows:

General Reserve	10.00

Since under the Banks & Financial Institutions Act, 2073, until the reserve equals the share capital, every year at least 20% of the net profits has to be allocated to the general reserve fund. Thereafter, at least 10% of net profits of each fiscal year shall be credited to such fund. The amount credited to the general reserve fund of bank or financial institution shall not be spent or transferred to any other headings without prior approval of Nepal Rastra Bank. Hence, this reserve is not distributable. Other undistributable reserves are:

Revaluation reserve		1.00
Share premium account		3.00
Capital Redemption Reserve		5.00
		19.00
Net Assets :		
Total Assets (excluding goodwill)		321
Less: Debenture	20	
Deposits	270	
Other liabilities	27	317
		4

(Goodwill is an intangible asset and its present valuation will have to be made and it cannot be distributed physically among the shareholders and so it s excluded for this purpose

Share capital +un-distributable reserve = 30 + 19 =49

Thus it cannot pay a dividend since its net assets are already less than the share capital + undistributable profits, if it distributed any dividends

The Act does not define 'dividend'. The Income tax Act defines a dividend – (a share of profit) as the distribution of profit and further explains and introduces the above European directive in Sec. 53(4) that the distribution will be deemed on distribution of profit only in case where the market value of assets is more than the aggregate of the market value of liabilities and capitalized profits. This only difference is that Sec. 53(4) of IT Act uses the market value whereas the European Directive does not mention market value but according to the Accounting Standards the financial investments have to be marked to market value. This rule mostly affects the financial institutions more than the profit making industries.

Sec. 182(6) of the Companies Act gives a guideline to ascertain the distributable profits. While arriving at the profits, the following should have been deducted:

(i) Pre-operating expenses;
(ii) Depreciation as prescribed by the Accounting Standards or other regulatory authorities;
(iii) Any amount to be paid or set aside out of the profits under the prevailing laws (e.g. Provision for bad debts and investments under the Nepal Rashtra Bank directives);
(iv) Any amount to be set aside for establishment of a reserve or savings fund before distribution of dividend under the prevailing law.

After making all the above adjustments, if there remains some profit, then only dividend can be distributed.

Dividend shall be proposed by by the Board and then it has to be approved at the annual general meeting by the shareholders. So, the date of declaration of dividend will be the date on which annual general meeting approved the dividend.

Dividend may be declared as a certain percentage on paid up value or at a certain rate per share where all the shares are equally paid up.

With regard to declaration of dividend, the following points may be noted:

(a) It is beyond the powers of a company to declare a further dividend after declaration of dividend at the annual general meeting;
(b) But a declaration of dividend at a general meeting other than an annual general meeting is not prohibited;
(c) There can be no declaration of dividend for past years in respect of which the accounts have already been closed at previous annual general meeting [*Raghunanda Neotia v. Swodeshi Cloth Dealers Ltd*. (1964) 34: Comp. Cas 570].

The declared dividend shall be paid within 45 days from the date of decision or declaration of dividend by the annual general meeting. If the dividend is not paid within 45 days then the dividend should be paid with interest at the prescribed rate. But three exceptions are provided for not paying the dividend within 45 days,

(a) If any law has prohibited the payment of dividend;
(b) The right to dividend is indispute;
(c) The reason beyond or any circumstances if it is not possible to distribute dividend before 45 days.

Sec. 182(11) makes provision that if the total amount of dividend is paid into a separate bank account within 45 days from the date of the meeting, then this section shall be deemed to have been complied with. This follows Sec. 205 of the Indian Companies Act. That is, the dividend amount must get out of the hands of the company within the prescribed date even though the shareholders may get the amount later. Such amount deposited into the separate account shall not be used for any purpose other than the payment of dividend. Here banker will have to be vigilant also that the amount is not utilized for any other purpose. Where the register of shareholders is entrusted to a Register entity, then the Register entity will make out the dividend warrant or dividend cheque in the individual name of the shareholders after verifying the shareholding on the date of the annual general meeting. In order to facilitate dividend warrant preparation only, the Register of shareholder are closed 20 days to 30 days ahead of the annual general meeting so that at the date of annual general meeting there are not pending share transfer applications. The person whose name appears on the register of shareholders as on the date of the annual general meeting or his legal representative only will be entitled to receive the dividend. Thus if a share transfer is made after the closing of the Register of shareholders but before the date of annual general meeting, only the transferor will be entitled to receive the dividend. Since the transfer will not be acted upon and only the transferor‘s name will appear in the register only he is entitled to the dividend. He may have to endorse the share warrant in the name of transferee, if

the contract provides that the transferee is entitled to receive the amount. Then transferor can pay the amount to the transferee respectively after receiving the dividend.

Sec. 182(5) makes a provision that except out of the amounts appropriated out of profits for payment of dividend, the company cannot pay dividend in any other way.

Payment of Interim Dividend

Interim dividend means a dividend declared by the Board of Directors before the declaration of dividend by the company at the annual general meeting and merges with the final dividend declared at the general meeting in respect of any financial year. In other countries, the interim dividend is declared in the middle of the year even before the accounts are audited on the basis of the results up to a period before the declaration of dividend.

Sec. 182(7) provides that subject to the other provision regarding the availability of profits etc, the Board of Directors of any company may declare an interim dividend in respect of the previous financial year under the following circumstances:

(a) There shall be power to pay interim dividend in the Articles of Association of the company;
(b) The financial statements of the previous year in respect of which interim dividend is proposed to be paid should have been audited and certified by the auditors and approved by the directors;

When the annual accounts are audited and approved by the Board, then the company may call the annual general meeting and get the dividend declared. Hence, interim dividend during the financial year in respect of that financial year is not prescribed under the Act. Only after the accounts are audited at the year-end or approved by the directors only, interim dividend can be given, i.e. if there is a delay in calling the general meeting or the company has cash which, it wants to be distributed early, then only the interim dividend is possible under the Act.

But such interim dividend shall be ratified at the forth coming annual general meeting.

Sec. 182(8) makes a prohibition on payment of any extra money as conveyance or any other allowance in cash or kind to be borne out of the funds of the company to the shareholders except the dividend declared at the general meeting.

Some banks used to pay Rs.100 traveling allowance to each member attending the meeting. Paper Manufacturing Company would give some paper packets or products of the company. Similarly Sugar Company would give ½ Kg of sugar to every member. Such gifts are totally prohibited now.

Sec.182(9) provides that if the dividend declared at the general meeting is not received by any shareholder for a period of 5 years from the date of general meeting at which is declared, then such unpaid dividend amount should be paid to Investor Protection Fund established under Sec. 183. Before transferring such amount to the Investor Protection Fund, the company will have to

given public notice giving 30 days time in a national daily, before the expiring of the five years period, to collect the unpaid dividend.

The rate of dividend can be regulated, if the articles so permit, according to the amount paid-up on each share where more amount has been paid up on some shares than on others.

Sec. 277 of England Act provides that, when a distribution is made to a member which he knows or has reasonable cause to believe, is made in contravention of the Act, he is liable to repay it or if it is in kind, then its value. In other words the payment though unlawful, is neither void nor voidable but can be recovered from any recipient of it who knows or ought to have known that it was unlawful.

In UK it is not necessary to make up losses of circulating capital incurred in previous years before paying dividends out of the current year's earnings.

But the Act does not provide any specific remedy against the director who authorized such unlawful distribution. But here the common law will step in. In Re-Exchange Bombay Co. [(1882) 21 Ch. D 519 CA] it was held that directors who pay dividends improperly may in certain circumstances be liable to compensate the company for the loss thereby caused. This principle has been applied to hold director so liable where the account failed to give a true and fair view of the company's financial situation as a result of accounting irregularities of which the directors aware [Barstow v. Queen Mote House plc (2001) 2 B.C.L.C 531 CA]. But it is not clear that the directors liability depends on their knowledge of the irregularities, since they may be relieved from liability when they have acted honestly in good faith and reasonably in paying the improper dividend [(under Sec. 99(4) & (5)]. One should not forget the possibility of action by the company against its auditors if it can be shown that their negligence led the director to approve a defective set of accounts.

Capitalization of profits

A company may in general meeting, on the recommendation of the board, resolve and convert into capital any sum standing to the credit of profit or loss account or reserve fund account or otherwise available for distribution if so authorized by its articles. As a general rule only such funds can be capitalized as would be available for dividend distribution.

"It has been the generally accepted view of the law of this country that, if the surplus on capital accounts results from a valuation made in good faith by competent valuators, and is not likely to be able to short term fluctuations, it may properly be capitalized".

When a distributable profit is capitalized, it is in essence a declaration of dividend combined with the application of that dividend on behalf of the shareholders entitle to participate in it in paying up shares to be allotted and issued to them in satisfaction of their rights of participation.

The advantage to the company is two-fold. A self-financing of this kind helps the company to rid itself of market influences. Secondly, it makes available capital to carry on a larger and more profitable business.

There must be a clear authority to capitalize profits in company‘s articles, for, otherwise, a shareholder can insist upon payment in cash.

It has been held by the Supreme Court f India in S*hri Gopal Paper Mills v CIT* [(1970) 2 SCC 80: AIR 1970 SC 1750] that the shareholders become the owners of bonus shares from the date of declaration and not from the date on which certificates are issued. The Gujarat High Court has, on the other hand, held in *CIT v Chunilal Khushaldas*[(1974) 44 Comp Cas 90] that bonus shares cannot be said to be acquired or held by a shareholder before they come into existence by allotment and issue. The above – mentioned Supreme Court decision was not cited before the court.

Bonus Shares

This relates to capitalization of profits by issue of shares instead of cash dividend. When profits are transferred to Capital Redemption reserve or revaluation on reserve that also amounts capitalization since no dividend can be paid out of such reserves. Similarly when bonus shares are issued out of the profits available for distribution, then that portion of profits becomes unavailable for payment of dividend and hence considered capitalized, since assets representing these have to remain in the company.

Sec. 179(1) lays down that bonus shares can be issued only out of profits available for distribution as dividend. For issuing bonus shares out of profits available for distribution, the company should pass a special resolution i.e. at a general meeting and the said special resolution should be approved by OCR before issuing or allotting the shares.

Under Sec. 56(6) for issuing bonus shares, the procedure of getting approval from the Securities Board or publishing a prospectus is not necessary. But such shares should be registered with the Securities Board in the case of public company for facilitating the transfer of the shares later.

Further Sec. 56(10) provide specifically that bonus shares shall not be issued by revaluation of assets but only out of profits or reserves created out of profits. But Sec. 179(1) is clearer that bonus shares can be issued only out of the profits available for distribution. Thus issuing bonus shares out of share premium account or capital redemption reserve or compulsory reserves created out of profits under the special statutes like Banking Companies Act or Insurance Act which are not profits available for distribution of it is totally prohibited under Sec. 179(1). Further share premium account is not reserve created out of profit to comply with sec. 56(10). Thus, Sec. 29(3) which provides for Share Premium account to be utilized for issuing bonus shares to issue, un-issued shares into fully paid up share is in contravention of Sec. 56(10) & 179(1). Since share premium account is not available for distribution of dividends. In India, there is no prohibition that bonus shares can be issued only out of profits available for distribution as provided in Sec. 179(1) in Nepal.

If the articles so authorize, a company has the ‘power to convert its accumulated undivided profits into bonus shares’. ‘Directors may capitalize any profits and allot to the ordinary shareholders in respect of the net amount capitalized fully paid-up shares of the company’. The amount may also be used in paying up any amounts for the time being unpaid on any shares. The

two sources from which bonus shares may be financed by Share Premium Account, and Capital Redemption Reserve Account.

Issue of bonus shares is bare machinery for capitalizing profits. There is no distribution of profit among shareholders.

A resolution was passed at a meeting of the company for issue of bonus shares to equity shareholders. The directors were authorized to decide the date of issue. A shareholder transferred his shares after the meeting but before the specified by the directors. It was held that he being no longer a shareholder at the date of the issue, he was not entitled to the bonus shares in respect of the shareholding which he had already transferred. [Rajiv Nag v. Quality Assurance Institute (India) Ltd. (2001) 105 Comp. Cas 178 CLB; Pradip Kumar Chetlongia v Bajaj Auto Ltd, (2005) 59 SCL 372 CLB, no right to bonus arises unless the claimant's name is appears in the register of members]

Where dividend was paid in face of the auditor‘s qualified report, the payment was held to be wrong. The statutory requirements cannot be waived by shareholders resolution in this respect. The recipient of such dividends were held to be constructive trustees for the amounts received by them.

Separate Bank Account for Dividend

Under the Indian Act, the amount of dividend including interim dividend has to be deposited in a separate bank account within 5 days from the date of declaration of such dividend.

As per Nepal Act, the dividend is to be paid to a separate bank account within 45 days from the date of decision to pay dividend Sec. 182(11).

Declared Dividend a Statutory Debt

Once a dividend is declared it becomes a statutory debt from the company to its shareholders. As pointed out by the Supreme Court in *Bacha F. Guzdar v CIT,* ‘the shareholders’ right of participation in the profits of the company exists independently of any declaration of dividend by the company. A declaration is necessary only for the enjoyment of profits. It will follow that once a declaration of dividend is made and it becomes payable, it will partake of the nature of a debt due from the company to the shareholder. But a declaration of dividend subject to remittances from Pakistan or subject to some other condition precedent is not a declaration at all because it does not create an immediately payable debt.

A dividend which has been declared, but not paid nor credited, may be revoked with the consent of shareholders. An interim declared dividend may be removed before payment.

Interim Dividend

The declaration of an interim dividend does not create a debt against the company. Dividends can be declared only by a resolution of the shareholders in accordance with the directors recommendation at a general meeting. But, if so permitted by the articles, the directors can

declare an interim dividend between two meetings. 'It doesnot create adebten force able against the company, for it is open to the Board rescind the resolution before payment'. Shareholders do not get any vested right under directors resolution declaring an interim dividend.

Mode of Punishment

In order to ensure prompt payment of dividend to shareholders, Section 162 imposes a penalty of Rs. 5,000 to 20,000 if a dividend has been declared and is not paid within forty five days from the date of declaration. The provision is sufficiently complied with if the dividend warrant is posted within the above time.

15 WINDING UP OF THE COMPANY

Generally, there are 2 types of liquidation of a company viz. voluntary liquidation and compulsory liquidation. The type of liquidation depends upon the solvency position of the company. It means, if any company is solvent and desires for liquidation, such liquidation is called voluntary liquidation. However, if the company is insolvent, the liquidation adopted by it is compulsory liquidation. The legal provision relating to solvent companies' voluntary liquidation shall be governed by Companies Act, 2063. However, the provision relating to insolvent companies' compulsory liquidation shall be governed by Insolvency Act, 2063.

In this way, the Companies Act 2063 provides only for voluntary winding up by shareholders whereas in India, there are two types of winding up:

(a) Members voluntarily winding up;
(b) Creditors voluntarily winding up.

But the Nepal'sCompanies Act provides for shareholders voluntarily winding up only. In the case of insolvent companies, the whole procedure has been transferred by the Insolvency Act, 2063 to the Company Court. Therefore the voluntary winding up by members of a company under the Companies Act is possible only in the case of solvent company which is in a position to pay off all its creditors & liabilities. A solvent company may be liquidated by a special resolution passed by the shareholders at a general meeting subject to the provisions in the Memorandum of Association, Articles of Association and the unanimous agreement.

According to Sec.126 (2), in the following circumstances, a company can be wound up under this Act:

(a) If the company is capable of paying off its loan and other liabilities in full;
(b) If no proceedings are in progress on an application for review of insolvency under the Insolvency Act or there is no circumstance under which the company will be liable for insolvency proceedings under the Insolvency Act.
(c) If the directors, after due investigation, gives a written declaration that the company is solvent enough to pay all the loans and other liabilities in full and the loans and liabilities payable by the company can be repaid within one year from the date of passing the resolution for winding up or in any other manner can be discharged in full.
(d) Such declaration as above has been presented to the general meeting called to discuss the winding up or declaration was made at the general meeting at the time of discussion of

winding up at the general meeting the special resolution passed for winding up the company and the declaration of solvency by the directors shall be filed with ROC within 7 days from the date of passing of the resolution.

While passing the resolution for winding up the company, to carry out the liquidation one liquidator should be appointed and the remuneration payable to him should also be decided.

While appointing the liquidator only the professional who has license under the Insolvency Act, 2063 could be appointed. The company shall intimate OCR within 7 days of appointing the liquidator.

After the appointment of the liquidator, the directors and other officers shall cease from these office/ post and the liquidator shall take over the management of the company and shall have the complete authority to exercise all the powers exercised by the directors and other officers.

On the liquidator taking charge of the operation and administration of the company, all the services of all the employees will automatically get terminated. However, the liquidator in order to provide him support on his work may retain some employees or appoint fresh employees.

The liquidator should complete his work within the time notified at the time of his appointment. If he is unable to complete the work within the notified time due to reasonable causes, then the time for completion may be extended by adopting the procedure employed while appointing him. That is calling a general meeting of the shareholders and getting their consent for the extension of time.

While appointing the liquidator, an auditor also qualified to be appointed under the Act should also be appointed by the general meeting.

In the course of winding up to decide whether a person is a creditor or the amount due to him, the procedure laid down in the Insolvency Act, 2063 has to be adopted.

If in the course of liquidation, the liquidator is satisfied that it will not be possible to pay all the creditors and liabilities in full, then the liquidator has to present a petition before the insolvency court for a review of the insolvency of the company.

The liquidator on entering office should take into his custody and control all the properties, accounts and all the documents and records.

Power & Duties of Liquidator

All the powers and duties that are available to a liquidator appointed under the Insolvency Law will be available to a liquidator appointed under voluntary winding up mutatis mutandis i.e. with mutual variation according to circumstances.

Without prejudice to the general principles, the liquidator has to perform the following duties:

(a) After appointment as liquidator, every six months prepare a statement of the income and expenditure and accounts and file with the OCR;

(b) Every six months after appointment, furnish progress report of the work carried out by him in connection with the liquidation to the shareholder of the company;
(c) To receive all the properties receivable by the company and to realize all the moneys to be collected, and to pay off all the creditors and other liabilities;
(d) After completing the work of discharging all the loans and liabilities to call the general meeting of the company and submit the report regarding the distribution of the remaining assets;
(e) As per the proposal for distribution of assets, if it is consented to by the shareholders holding at least 75% of the total paid up capital of the company, then distribute the assets accordingly.
(f) After the work relating to liquidation is completed, i.e. by realizing all the assets, paying off all the creditors and liabilities and distribution of the remaining assets to the shareholder, the liquidator shall prepare a report regarding the assets realized, loans and liabilities paid and the distribution made to the shareholders, get them audited and along with the auditor's report submit to OCR duly certifying that the liquidation work was over and the company has been wound up.

On receipt of above report of winding up of the company, OCR shall pass an order canceling the registration of the company and remove the name from the register of companies maintained by it.

The liquidator appointed as per insolvency Act, 2063, shall send to OCR regarding information of completion of dissolution process of company. Upon receiving the information, the OCR shall keep record of cancellation such company and after such record the company shall deemed to be cancelled.

If any creditor or shareholder comes to know that in the course of liquidation, there has some irregularity happened, then the creditor or the shareholder may file a complaint with the Court within 15 days from the date of coming to know such irregularity.

Similarly if it appears to the liquidator that any director or employee or officer of the company has done any fraud or cheating against the company, then the liquidator can take legal action against such person as per the prevailing law.

The commencement of liquidation proceedings under this Act shall not affect the rights of any secured creditors (who has given any loan against security of assets of the company) with regard to his rights to use the property secured accounting to the law or to make any other arrangement with regard to such property given as securities.

16 PROTECTION OF SHAREHOLDERS

Chapter 12 of the Companies Act, 2063 deals with the rights of the shareholders in case any person cause loss to the company by their conduct or do anything beyond their jurisdiction and the shareholder has been specifically empowered to seek the help of court in such situation.

This is a new provision that has been brought out due to various judicial pronouncements in such situation in various cases in England and other commonwealth countries and that has been enshrined in the English Companies Act 1985. Let us see the development of cases in England to understand the principles involved in ascertaining whether there has been action against the interest of the company / shareholders and the various remedies awarded by the court.

The main elements of the directors fiduciary duties are

(a) that the directors must remain within the scope of the powers which have been conferred upon them;
(b) that directors must act in good faith in what they believe to be the best interests of the company;
(c) that they must not fetter their discretion as to how they shall act;

The final three categories are all examples of the rule against directors putting themselves in a position in which their personal interests (or duties to others) conflict with their duty to the company. However, it is useful to sub-divide the 'no conflict' principle in this way because the specific rules implementing the principle differ according to whether the conflict a rises:

(a) out of a transaction with th ecompany;
(b) out of the directors' personal exploitation of the company's property, information or opportunities ; or
(c) out of the receipt from a third party of a benefit for exercising their directorial functions in a particular way.

Not Breaking the Constitution

The main source of the directors powers is likely to be the company's constitution (MoA & AoA), and the MoA & AoA, therefore, is likely also to be a source of constraints on the directors powers. The articles may confer unlimited powers on the directors, but they are likely in fact to set some parameters within which the powers are to be exercised, even if the limits are generous.

This principle was recognized in the early years of modern company law and is reflected in a number of nineteenth century decisions, involving usually the purported exercise by directors of powers which were *ultra vires* the company or payments of dividends or directors remuneration contrary to the provisions in the company's articles. [*Leeds Estate Building and Investment Company v Shepherd* (1887) 36 Ch.D. 787. It might be said that the requirement upon the directors to repay the dividends was based on the illegality of their payment as a matter of statute or common law, but the directors were also required to repay their remuneration, the payment of which was objectionable only because it was done in breach of the company's articles. (The article entitled the directors to remuneration only if dividends of a certain size were paid, a rule which, perhaps naturally, encouraged the directors not to be too careful about observing the restrictions on their dividend payment powers.)

Guinness v Saunders (1990) 2 A.C. 663, HL - fixing of directors remuneration by a board committee, rather than the full board, in breach of the articles meant that the recipient director had to repay the money. In neither case, of course, was the third party a true outsider.

Equally, where directors act outside the scope of their powers under the constitution, s.104 provides that that section does not affect any liability incurred by the directors by reason of the directors exceeding their powers. Where the board of directors enter into a transaction on behalf of the company and in so doing exceed any limitation on their powers under the company's constitution and the third party contracting with the company is a director of the company, the protections do not apply so as to protect the director and the transaction is in principle voidable at the instance of the company. [But note that the transaction is not void, as it would be at common law. It will cease to be avoidable if

(a) restitution of the subject-matter of the contract is not possible;
(b) the company has been indemnified for the loss suffered;
(c) the rights of bona fide purchasers without notice have intervened; or
(d) the shareholders in general meeting have ratified the transaction.]

Improper Purposes

Frequently, the directors will not be actuated by a single purpose and then the test of legality must be applied to the dominant or primary purpose which the directors had and which, naturally, the court must first identify.

Perhaps the greatest puzzle in this area is to know by what criteria the courts judge whether a particular purpose is proper. This is generally stated to be a matter of construction of the articles of association. Hence, the test is an objective one, even if it is applied to the directors subjective motivations. In *Smith v Ampol,* however, the clause giving the directors powers to issue shares was drawn in the widest terms. The 'purposes' limitation which the Privy Council read into the directors' powers derived not from a narrow analysis of that clause, but from placing the share issue power within the company's constitutional arrangements as a whole, as demonstrated by the terms of its memorandum and articles of association. [The constitution of a limited company normally provides for directors, with powers of management, and shareholders, with defined voting powers having to appoint the directors, and to take, in general meeting, by majority vote, decisions on matters not reserved for management. Just as it is established that directors, within their management powers, may take decisions against the wishes of majority shareholders, and indeed that the majority of shareholders cannot control them in the exercise of these powers while they remain in office so it must be unconstitutional for directors to use their fiduciary powers over the shares in the company purely for the purpose of destroying an existing majority, or creating a new majority which did not previously exist. To do so is to interfere with that element in the company's constitutions which is separate from and set against their powers‖ (1974 A. C. 821 at 837, PC). This principle was applied by the Court of Appeal in *Lee Panavision Ltd v Lee Lighting Ltd* (1992) B.C.L.C. 22 where the incumbent directors entered into a long-term management agreement with a third party knowing that the shareholders were proposing to exercise their rights to appoint new directors.] In *re Smith and Fawcett Ltd.* [(1942) Ch. 304, where in a quasi-partnership company it was held that the directors, in exercising a power to refuse to register a transfer of shares, could take account of any matter which they conceive to be in the interests of the company such matters, for instance, as whether by their passing a particular transfer the transferee would obtain too great a weight in the councils of the company or might even perhaps obtain control.

Where the directors act for an improper purpose, their act is voidable by the company, not void, as it is in the case where the directors purport to exercise a power they do not have.

Good Faith

We have discussed the duty of directors to act in good faith in what they believe to be the best interests of the company already to some extent, because it is highly relevant to the issue of specifying the beneficiaries of directors duties. It is the 'core duty' of directors, because it applies to every decision which the directors take, whether they are pressing on the margins of their powers under the constitution or not and whether or not there is an operative conflict of interest. The issue which then arises is how the courts should test propriety of purpose.

Unfettered Discretion

Since the directors powers are held by them as fiduciaries of the company they cannot, without consent of the company, fetter their future discretion. Thus, it seems clear as a general principle, despite the paucity of reported cases on the point, which directors cannot validly contract (either with one another or with third parties) as to how they shall vote at future board meetings or otherwise conduct themselves in the future. [Contrast the position of shareholders who may freely enter into such voting agreements. In a judgment of the Australian High Court [*Thorby v Goldberg* (1964) 112 C.L.R. 597, Aus.HC.]: "There are many kinds of transaction in which the proper time for the exercise of the directors discretion is the time of the negotiation of a contract and the not at which the contract is to be performed. If at the former time they are bona fide of opinion that it is in the best interests of the company that the transaction should be entered into and carried into effect, I can see no reason in law why they should not bind themselves to do whatever under the transaction is to be done by the board".

Indeed, it may be that if there is a voting agreement between all the members and directors which provides that they shall vote together at all meetings, whether general meetings or directors' meetings, the parties to it will be bound *inter se,* and only if there are other members or directors will they be able to complain.

A good illustration of this is afforded by *Re W & M Roith Ltd.* There the controlling shareholder and director wished to make provision for his widow. On advice he entered into a service agreement with the company whereby on his death she was to be entitled to a pension for life. On being satisfied that no thought had been given to the question whether the arrangement was for the benefit of the company and that, indeed, the sole object was to make provision for the widow, the court held that the transaction was not binding on the company.

The Common Law Rule and its Amendment by the Articles

By the middle of the nineteenth century it has been clearly established that the trustee-like position of directors was liable to vitiate any contract which the board entered into on behalf of the company with one of their number. This principle receives its clearest expression in *Aberdeen Railway v Blaikie* in which a contract between the company and a partnership of which one of the directors was partner was avoided at the instance of the company, notwithstanding that its terms were perfectly fair. Lord Cranworth L.C. said on thatoccasion: "A corporate body

can only act by agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge, shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting, or which possibly may conflict, with the interests of those whom he is bound to protect. So strictly is this principal adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into".

It is important to note that this principal means that a director is in breach of duty, provided there is a conflict of interest which is not just fanciful, whether or not the conflict had an effect upon the terms negotiated between the parties to the transaction and whether or not the terms of the transaction could be regarded as fair, even if affected by the conflict of interest. It is therefore a strict rule: proof that exactly the same terms would have been negotiated, had there been no conflict of interest, will not save the director.

Is Litigation in the Interests of the Company ?

In every case where it is arguable that a director has infringed his or her duties to the company, the company should be contemplating litigation. The test, it is submitted, is whether it is in the best interests of the company that litigation be instituted, and that question can be answered only on the facts of a particular case. It is easy to imagine many reasons why litigation would actually leave the company worse off than it was before. There may be doubts about whether a verdict in favour of the company will be obtained, either because of disputes about the law or because of difficulties of proving the events said to constitute the breach of duty. Or the defendants may not be in a position to meet the judgment even if the litigation is successful. Or the senior management time spent on the litigation might more profitably be used elsewhere or, finally, whilst winning the legal arguments and obtaining an enforceable remedy, the company may suffer collateral harm which outweighs the gain from the litigation [for example, the reputational harm suffered by McDonalds even though it won most of its claims in the 'McLibel' trial] In other words, the decision whether to initiate litigation in respect of an alleged breach of directors duty will not always be an easy one, and a negative decision is not necessarily a sign that the company is being too lax towards its directors.

Litigation Decisions Taken by the Board or the Shareholders Collectively

That the board will have the power under the constitution of most companies to initiate litigation against wrongdoing directors seems clear, for it will be part of its standard management powers. That the board may be unwilling always to sue the wrongdoing director when it is in the best interests of the company to do so, however, seems equally clear. The wrongdoers may be a majority of the board or may be able to influence a majority of the board, and the same incentives which operated to cause the directors to break their duties in the first place may cause them to utilize their board positions so as to suppress litigation against them. This is not always the case. The board may act in an independent minded way or, perhaps more likely, the directors may have lost the influential positions on the board which they had when they committed the original wrongdoing. Thus, the previous board may have been replaced by a new set of directors as a result of a take-over or, the company having become insolvent, the board has been replaced

by an insolvency practitioner, acting in one capacity or another on behalf of the creditors. Indeed, the importance of litigation against wrongdoing directors (and other officers of the company) in this situation is recognized in [s.212] of the Insolvency Act [1986] which gives liquidators in a winding up the benefit of summary procedure for the enforcement of, inter alia, breaches of fiduciary duty and of the duty of care on the part of directors, though the section does not extend the range of the duties to which directors are subject.

Despite these examples of litigation against wrongdoing directors being initiated by those in charge of its management, it would obviously by unsound policy to leave such decisions exclusively with the board of the company. If the board decides to sue, all well and good, but the common law seems to take the view that, even if the board does not wish to sue, it is open to the shareholders collectively to decide to do so.

Further, even in the absence of wrongdoer control of the general meeting, it is not obvious that the general meeting will come to consider the exercise of its power to initiate litigation. The wrongdoing directors, presumably, will not take steps to put the matter before the general meeting, unless they think the general meeting will support them, and so the shareholders as a whole may simply remain in ignorance of the fact that there is an issue for them to discuss. One or more shareholders may know of at least some of the relevant facts, and may seek to use their powers, to have the matter put on the agenda of an ANNUAL GENERAL MEETING or to have an EGM called to discuss the issue. In both cases, the support of substantial numbers of fellow shareholders will be required to force the company to take these steps and the support of half the shareholders present and voting at the meeting actually to pass a resolution in favour of litigation.

The same situation may give rise to wrongs both by and against the company, and the individual shareholder‘s position will vary according to which wrong he seeks to redress. A parallel can be drawn between breaches of the articles and *ultra vires* acts, where this distinction has been recognized in the decisions and, now, in the statute. If the directors embark upon an *ultra vires* transaction, they will be in breach of their duty to the company, but so will the company be in breach of its contract with the shareholders. So the company appears as both wrongdoer and victim. In *Taylor v NUM (Derbyshire Area)* the plaintiff successfully sued his trade union in a personal capacity to obtain an injunction restraining the officials of the union from continuing an *ultra vires* strike, but failed in his claim for an order requiring the same officials to restore to the union the funds already expended on the strike.

In other words, the company may be regarded as breaching its contract with the member if it seeks to act upon a resolution improperly passed and should be restrainable by the members, but for the loss (say the wasted costs of organizing the meeting) caused to the company by the chair of the meeting in not conducting it in accordance with the company‘s regulation, the company is the proper plaintiff.

The default rule suggested will be that obligations imposed on the company by the constitution will be enforceable by individual shareholders, subject to their seeking individual, rather than corporate, relief and to their not obtaining any relief if the breach of the constitution would have

made no differences to the decision reached. It would be open to companies to opt, wholly or partly, to make the articles not legally enforceable by individuals through contractual actions, but in that situation the current case-law equally would be irrelevant.

However, personal rights maybe found elsewhere than in the articles and so the scope of the argument that *Foss v Harbottle* has no application to personal rights has a rather broader ambit. Although the company‘s constitution is the main source of rights for the shareholder against the company, it is not the exclusive source of such rights, especially if the shareholder is prepared to cast his or her net wider and sue the directors as well as, or instead of, the company. The shareholder may have rights derived from the general law, as was the situation case in *Prudential*, where the shareholder asserted the directors were liable in the tort of conspiracy as against the members of the company as well the company itself. There seems to be no principled reason against the enforcement of such actions, though the remedies may have to be carefully tailored so as to avoid double recovery. Exceptionally, the directors may owe the shareholder even a fiduciary duty directly, in which case the F*oss* rule would seem irrelevant since the shareholder is suing to enforce his own, not the company‘s, fiduciary rights. Indeed, the *Foss* would be substantially undermined if the courts were to expand the range of duties owed by directors to shareholders directly. However, so long as the courts remain attached to the policies underlying the rule, so directors advice to shareholders on the exercise of the rights attached to their shares will probably remain the prime area for the recognition of direct fiduciary duties.

The rule in F*oss v Harbottle* seeks to address is one of *locus standi*: in what circumstances may an individual shareholder seek to enforce a right which is vested, not in him – or herself, but in the company. [In *Hogg v Cramphorn* (1967) Ch. 254, the individual shareholder was allowed to sue but judgment in his favour was suspended whilst a general meeting of the shareholders was called to consider approving the directors actions, which they in fact did, so that the litigation was ultimately fruitless. And in *Bamford v Bamford* (1970) Ch. 212, CA, it was held that the improper issue of shares was ratifiable].

This is all fairly straightforward. The confusion in this area begins to emerge when one considers the form in which an action by an individual shareholder to enforce the company‘s rights is required to be cast. Some of the confusion has been cleared up in recent years by the decision of the Court of Appeal in *Wallersteiner v Moir* (No.2). This clearly recognized for the first time the terminology of the derivative action‘ (in place of the former obscure ‘minority shareholder‘s action’), and the latter seems to have removed the former requirement that the derivative action be brought in representative form, simply defined a derivative action as one brought ‘where a company, other incorporated body or trade union is alleged to be entitled to claim a remedy and a claim is made by one or more members of the company, body or trade union for it to be given that remedy’. However, the requirement that the company etc on whose behalf the claim is brought be made a defendant to the claim is retained. Although it is easy to appreciate that the company is joined as a defendant in order that it may be bound by and benefit from the judgment and that it cannot be made a claimant if neither the board nor the general meeting have consented to this, nevertheless it is highly misleading to find that an action to enforce the company's rights takes the form, apparently, of an action against the company. The cost of the action was carried by the claimant shareholder, whilst recovery would be ordered in favour of the company. This

injustice was partially remedied in *Wallersteiner* where the Court of Appeal recognized that in appropriate cases the shareholder should be indemnified by the company against the costs of bringing the action on the company‘s behalf. This has been incorporated in Sec.140(6).

The ‘ownership’ of the rights being protected in, respectively, personal and derivative actions lies in very different hands. On the other hand, the same set of facts may give rise to infringements of both the shareholders and the company‘s rights. The question is thus bound to arise as to whether personal and corporate rights may be asserted in the same action.

In *Heron International Ltd v Lord Grade*, where, in the context of a proposed take-over, the Court of Appeal distinguished between the harm inflicted on the company's assets by the assumed recklessness of the directors (recoverable only in a derivative action) and the harm suffered directly by the shareholders individually through their resulting inability to accept a higher take-over offer for their shares.

There are other minor differences between the personal and the derivative action, arising out of the differences in the rights protected. A derivative action, since it enforces the company‘s rights, may be initiated by a shareholder even though it relates to matters which occurred before he or she became a member, whereas in relation to an action to enforce the member's personal rights it is difficult to envisage circumstances where this could arise, since the rights in question presumably were acquired only upon admission as a member of the company. Further, since the derivative action is an invention of equity to allow enforcement of the company‘s rights, it is available only as a matter of the court's discretion. The plaintiff will be disqualified from bringing a claim if he or she does not come to court with ‘clean hands’, for example, if the plaintiff has participated in the wrong of which complaint is made. The claim may also not be allowed to proceed if the court forms the view that it is being pursued for an ulterior purpose and not bona fide for the benefit of the company, or if the shareholder has acquiesced in the wrong.

Majority and Minority Shareholders

Unfair treatment of the minority by the majority may occur, obviously, through decisions taken by shareholders in general meeting. Thus, the general meeting becomes a focus of rules designed to protect the minority, and we shall examine these rules in our system. A simple majority of the shareholders has the power to replace the members of the board at any time and for any reason, the majority‘s influence may well be articulated through decisions of the board, as well as, or instead of, through shareholder decisions. In fact, given the division of powers between the board and the general meeting, normally in favour of the former in all but small companies, majority shareholder influence over the company is very likely to involve some element of board decision-making.

Unfair Prejudice

Section 459 English Act provides that any member may petition the court for relief on the grounds that ‘the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interest of its members generally or some part of the members

(includingat least himself) or that any actual or proposed actoromission of the company (including any actoromission on its behalf) is or would be so prejudicial'.

It is clear that the section is wide enough to catch the activities of controllers of companies, whether they conduct the business of the company through the exercise of their powers as directors or as shareholders or both. The section may even apply to the conduct of corporate groups. Although the conduct of a shareholder, even a majority shareholder, of its own affairs is excluded from the section, nevertheless where a parent company has assumed detailed control over the affairs of its subsidiary and treats the financial affairs of the two companies as those of a single enterprise, actions taken by the parent in its own interest may be regarded as acts done in the conduct of the affairs of the subsidiary. The 'outside' shareholders in the subsidiary may thus use the section to protect themselves against exploitation of the subsidiary by the majority-shareholding parent company.

Unfair Prejudice and the Derivative Action

It may seem off at first sight that a right petition vested in the individual member or creditor may be used to secure the redress of wrongs done to the company, especially those committed by its directors.

In addition to these direct wrongs to the minority, there is the type of case in which a wrong is done to the company itself and the control vested in the majority is wrongfully used to prevent action being taken against the wrongdoer. In such a case the minority is indirectly wronged. There are a number of reported cases in England under the current legislation in which petitions have been entertained by the courts where the wrongdoers' conduct consisted wholly or partly or wrongs done to the company. [*Re Stewarts (Brixton) Ltd* (1985) B.C.L.C. 4; Re *London School of Electronics* (1986) Ch. 211; *Re Cumana Ltd* (1986) B.C.L.C. 430 (all involving various forms of diversion of the company's business to rival companies in which the majority were interested, i.e, situation of the type found in *Cook v Deeks*(1916) 1 A.C. 553, PC, above, p.439); *Re A Company Ex p. Glossop*(1988) 1 W.L.R. 1068 (exercise of directors powers for an improper purpose); *re Saul D. Harrison & Sons Plc* (1995) 1 B.C.L.C. 14 (failure of directors to act bona fide in the interests of the company). In not all these cases was the allegation in question made out on the facts.

In *Anderson v Hogg* the Inner House of the Court session (Lord Prosser dissenting) did award relief to the company, where the unfair prejudice was based on the unlawful payment by the respondent director of remuneration to himself. Without detailed consideration of the point, the director was ordered to return the money to the company.

Legitimate Expectations on Equitable Considerations

The important step taken by the courts, as described in the previous section, can be characterized by saying that they recognized that protects expectations and not just rights. Borrowing from public law, it is sometimes said that the decision protects the 'legitimate expectations' of the petitioner. Whatever the language used, the difficult issue is to distinguish those expectations of the petitioner which are to be classified as 'legitimate' and so as deserving of legal recognition

and protection, from those expectations which the petitioner may harbour as a matter of fact but which the courts will not protect. It is suggested that the decisions of the courts to date have succeeded in identifying one clear class of legitimate expectation and have hinted at a range of other situations.

Other Categories of Unfair Prejudice

A feature of some of them is reasoning by analogy from established standards, that is, using the unfair prejudice provisions to extend established rules into adjacent areas where the provisions do not formally apply. Thus, in *Re A Company* the judge used the provisions of the City Code on Takeovers and Mergers as guide to what required the directors of a target company should do by way of communication with their shareholders, even though the target was a private company and so outside the formal scope of the Code. In *McGuiness v Bremner Plc* the judge found a useful analogy in Art. 37 of the current version of Table A, even though the company in question had not adopted that version, when deciding whether delay on the part of the directors in convening a meeting requisitioned by the petitioners was unfairly prejudicial. Again, such reasoning by analogy plays a useful role in defending the courts against the charge of unwarranted or in expert interference.

Prejudice and Unfairness

There is no requirement that the petitioner come to the court with the clean hands, but the petitioner‘s conduct might mean that the harm inflicted upon him was not unfair or that the relief granted should be restricted. Again, the petitioners may have consented to, and even benefited from, the company being run in a way which would normally be regarded as unfairly prejudicial to their interests; or they might have shown no interest in pursuing their legitimate interest in being involved in the company.

Reducing Litigation Costs

A major issue which has emerged under the unfair prejudice jurisdiction is the length and, therefore, the cost of trails of these petitions. Although the decision of the House of Lords in *O‘Neill v Phillips* has done something to reduce the scope of the issues to be explored, the court may still find itself trawling through a great deal of the history of the relations between petitioner and respondent, to establish, first, the existence of any informal understandings and, second, whether they have subsequently been breached. All this will typically occur in relation to small companies, whose net value may not be large.

However, the courts themselves have developed a technique for encouraging an agreed solution to unfair prejudice claims. Where it is clear, as it will normally be, that the relationship between the petitioner and the remainder of the members cannot be reconstituted by the court and that the only effective remedy available to the minority is to have their shares purchased at a fair price, then if a suitable *ad hoc* offer is made to the petitioner for the purchase of the shares or there is a suitable mechanism to this effect in the company‘s articles, but the petitioner decides to proceed with the petition, rather than to accept the offer or use the mechanism, that will be seen to be an abuse of the process of the court and the petition will be struck out. In *O‘Neill v Phillips* Lord Hoffmann was keen to endorse and encourage this procedure as he was set out the basis of the

unfair prejudice claim itself. His lordship thought that a petitioner could not be said to have been *unfairly* prejudiced by the respondent's conduct if:

(a) the offer was to buy the shares at a fair price, which normally would be without a discount for their minority status (see below);
(b) there was a mechanism for determination of the price by a competent expert in the absence of agreement;
(c) to encourage agreement the expert should not have reasons for thevaluation;
(d) both sides should have equal access to information about the company and equal freedom to make submissions to the expert; and
(e) the respondent should be given a reasonable time at the beginning of the proceedings to make the offer and should not be liable for the petitioner's legal costs incurred during that period.

Cases where offers from the respondent have not blocked a petition have usually involved offers which did not give the petitioner all he or she would get if successful at trial or have involved valuation by a non-independent expert. But the Nepal Act Sec. 140(4) provides for the court to order the company to purchase the shares by ordering reduction of share capital. But it ahs not indicated at what price the shares are to be purchased. But Sec. 140(3) gives wide power to the court to pass appropriate order.

Remedies

A share purchase order gives the petitioner an opportunity to exit from the company with the fair value of his or her investment, something which, in the absence of a court order, is often not available to the shareholder in a small company.

The crucial question in this buy-out process is how is the court to assess the fairness of the price to be paid for the shares. Two important issues have emerged in the valuation process. The first is whether petitioner's shareholding should be valued *pro rata* to the total value of the company or whether its value should be discounted on the basis that it is *ex hypothesi*a minority holding and so does not carry with it control of the company. In *Re Bird Precision Bellows Ltd* it was established the principle was *pro rata* valuation because the buy-out had been forced upon the minority by the unlawful acts of the controllers. However, the court accepted that, if the petitioner's conduct had not been blameless, the value of the shareholding might be discounted for its minority status. Further, if the petitioner had bought the shareholding at a price which reflected its minority status or it had devolved upon him or her by operation of law, the full *pro rata* value might not be appropriate.

The second issue concerns timing. The value put on shares, whether on a *pro rata* or on a discounted basis, will often crucially depend on when the value of the company is assessed. The courts have given themselves the widest discretion to choose the most appropriate date. The normally competing dates are a date close to when the shares are to be purchased and the date when the petition was presented. In *Profinance Trust SA v Gladstone*, the Court of Appeal thought that the former had become the presumptive valuation date, but that there were many circumstances when an earlier date might be chosen for example, where the unfairly prejudicial conduct had deprived the company of its business, where the company had reconstructed its

business or even that there had been a general fall in the market since the presentation of the petition.

Winding up on the Just and Equitable Ground

A winding-up petition triggers the Insolvency Act which requires court's consent for any disposition of the company's property after the petition is presented. This ability to paralyze, or at least disrupt, the normal running of the company‘s business adds to the negotiating strength of the petitioner but is hardly legitimate if a petition could give him or her all that is required. Consequently, a Practice Direction seeks to discourage the routine joining of winding-up petitions to unfair prejudice claims, unless a winding-up remedy is what is genuinely sought. The force behind the Practice Direction is provided by the Insolvency Act 1986, to the effect that the court need not grant a winding-up order if it is of the opinion that some alternative remedy is available to the petitioners and that they have acted unreasonably in not pursing it. It would not seem unreasonable use of this power for the courts to insist that, where a more flexible remedy is available, the petitioner should be confined to it. That would be a natural consequence of the fact that the statutory alternative to a winding-up order has finally come of age.

Prohibition on Directors and Office Bearers From Taking Unauthorized Actions (Sec. 138)

(1) The shareholders of a Company may file a petition to the court for an appropriate order on the basis of his suspicion that the business of the Company has been or is about to be run in a manner opposed to the rights and interests of any shareholder, or that any action taken or about to be taken by the Company, or the failure of the Company to do something which it has to do, has undermined or may undermine the rights and interests of any shareholder.
(2) While filing a petition under Sub-Section (1), the petitioner shareholder shall be required to prove that the Director, Managing Director, Manager or officer bearer managing and controlling the Company has, by acting in contravention of the Memorandum or Articles of Association or the unanimous agreement, practiced or is about to practice discrimination with *mala fide* motives or in an improper manner.
(3) On receipt of a petition under Sub-Section (1) or (2), the court shall examinethe Company or its Directors or office bearers, and issue an appropriate order.

Section 139 gives the power to the ROC, on receipt of report from the Inspector appointed to enquire into the affairs of the company, to approach the court for remedial action if the ROC on the basis of the report believes that any transaction of the resulting

(a) against the interest of any or all or any particular class or group of shareholders; or
(b) if the affairs of the company has been conducted or is about to be conducted;
(c) if the action undertaken to be done by the company or
(d) if the company omits to do any act which it is supported to carry out has caused or likely to cause harm to the shareholders.

In that case ROC can file a complaint in the court against the company, its director or officers. The court is given wider powers to give proper order according to the circumstances of the case.

Under sec. 140, in similar situation described above, the shareholder also can file a complaint in the court.

While filing the complaint, the shareholder has to produce proper evidences to show that the director managing or controlling the company managing director, managers or any officer has acted or is about to act in violation of the memorandum of association or articles of association or unanimous agreement or mala fide, the court shall enquire with the concerned company, director or officer, on the matters given in the complaint and if the matters complained is found to have been proved from the evidence collected, the court can give appropriate order in the name of the company to afford proper remedy.

Sub-section (3) of Sec. 139 details the various types of order, that the court can pass as appear appropriate notwithstanding anything contained in the memorandum & articles of association or the unanimous agreement.

Remedy for Actions Taken Against the Rights and Interests of Shareholders

(1) Any shareholder of a Company may file a petition to the court for an appropriate order on the basis of his suspicion that the business of the Company has been or is about to be run in a manner opposed to the rights and interests of any shareholder, or that any action taken or about to be taken by the Company, or the failure of the Company to do something which it has to do, has undermined or may undermine the rights and interests of any shareholder.

(2) While filing a petition under Sub-Section (1), the petitioner shareholder shall be required to prove that the Director, Managing Director, Manager or office bearer managing and controlling the Company has, by acting in contravention of the Memorandum or Articles of Association or the unanimous agreement, practiced or is about to practice discrimination with mala-fide motives or in an improper manner.

(3) On receipt of a petition under Sub-Section (1), the court shall examine the concerned Company, Director or office bearer, and, if it finds the claim made in the petition to be based on facts, issue any order deemed appropriate by it in the name of the Company in order to provide a remedy for the same

(4) While issuing an order under Sub-Section (3), the court may, without prejudice to the generality of that Sub-Section, also issue any of the following orders, notwithstanding anything contained in the Memorandum or Articles of Association or the unanimous agreement:
   (a) To stop any action taken against the rights and interests of any or all of the shareholders, and run the business of the Company according to rules in the future.
   (b) To stop any action being taken or about to be taken by the company, or order the Company to do anything which it has not done or is not going to do.
   (c) To institute a civil suit as directed by the court against any person on behalf of the Company.
   (d) To reduce the capital of the Company by fulfilling the formalities laid down in this Act, purchase the shares held by any shareholder, and arrange for the refund of the money.
   (e) In case any discrimination practiced against any shareholder has caused any loss to him, to have the loss thus caused to him realized from the Company or the person who had practiced such discrimination.
   (f) To liquidate the Company.
   (g) To order any other shareholder of the Company, or the Company itself, to purchase the shares registered in the name of any shareholder of the Company.

(h) To have the Director or office-bearer who has caused any loss or harm to the Company or its shareholders compensate for the same.
(i) In case the Company itself is to purchase the shares, to order the Company to reduce its share capital by considering it to have reduced its share capital by adopting a special resolution to that effect, and to issue other appropriate orders to effect necessary alterations in the Memorandum or Articles of Association of the Company if it so becomes necessary as a result there of.

(5) Notwithstanding anything contained in Sub-Section (1) or (2), in case the Company or any Director or person who manages and controls the Company, or any of its employees, has not done something that it / he should have done, has not done something that it / he should have done, or has done something that it / he should not have done, or has behaved in a discriminatory manner, and in case any person has suffered any loss or harm as a result thereof, a remedy for such person shall not be deemed to be limited to this section alone, and such person may also initiate action on his own behalf or on behalf of all the shareholders collectively for any remedy available under other current law.
(6) In case collective remedy is demanded under Sub-Section (5), the court may issue an appropriate order by subjecting or all of the shareholders belonging to the concerned category to necessary examinations, or without doing so.
(7) In case the Company has made any alteration in its Memorandum or Articles of Association on the orders of or according to the orders of the court as mentioned in Sub-Section (7), the alterations shall be deemed to be equivalent to any alterations made by the General Meeting of the Company by adopting a special resolution to that effect.
(8) The Office must record in the Company Register the following orders issued by the court under this Sections:
    (a) Any order issued for reducing the share capital of the Company;
    (b) Any order effecting an alteration in the Memorandum or Articles of Association of the Company.

Sec. 139(4) extends the right of the shareholders being not limited to the procedure laid down in this section. But he may initiate action under the other laws also either individually or in a group for appropriate remedy.

For the protection of the rights of the shareholder, the court can also pass order to amend any provision in the Memorandum & Articles of Association or not to amend any provision. In such case the company is not allowed to amend the Memorandum & Articles of Association without the prior approval of the court [139(7)].

If the Court orders any amendment to the Memorandum & Articles of Association, the court order will be deemed equivalent to a special resolution passed by the company in general meeting. [139(8)]

ROC also based on the order of the court shall enter in their record of the concerned company, the following matters:

(a) Order given for reduction of share capital;
(b) Order amending the Memorandum & Articles of Association.

The Act provides that the right conferred under this section 139 will be available to legal representative of a shareholder, whose name has not yet been entered in the Registered of members maintained by the company but who has acquired right to the shares through proper legal process.

Sec. 140(1) gives the powers to company to file a suit against the following to enforce any right or interest:
(a) Any directors;
(b) Any offices;
(c) Controlling shareholders as per unanimous agreement.

Under Sec.140(2) if the concerned company does not take any action, then one shareholder holding 2½ percent or more of the paid up capital singly or more than one shareholder holding five percent of the paid capital as a group can file a suit on behalf of the company against the above persons.

But he must demonstrate to the court what efforts he made to induce the company to file the case [Sec.140 (3)]. Then the shareholders are given a right to derivative action on behalf of the company.

On filing the case, the court can decide whether it is proper for the company to pursue the case or the complaining shareholders should proceed with the case. If it is found that the case should be processed by the company, the court can order the company to pursue the case against the above persons [Sec.140 (4)].

Once the suit has been filed, the same cannot be withdrawn or compromised except on the inclusion of the conditions prescribed by the court. The provisions follow section 347 of the English Companies Act [Sec.140 (4)]. But the power given to shareholder, after filing the case in the court to require the company to supply whatever information relating to the subject matters in order to decide in what way to proceed with the litigation is provided in Sec. 347 of the English Companies Act. But such right is not expressly provided in the Act. According to Sec. 347, this right extends to both information in the company‘s possession or control and which is reasonably obtainable by the company (e.g. from another group company). But the court may enforce this right by order under sec. 139(3). But under the Nepal Companies Act, the court has been given powers to pass appropriate orders and can direct the company to produce the information. But whether the court will be willing to pass such orders has to be examined.

17 AMALGAMATION & RECONSTRUCTION

(Note: Even though it is commonly called ‘merger’ in Nepal, in the international accounting vocabulary the word ‘amalgamation’ is used and the same is used here to make the students familiar with the accepted international terminology used in the IAS and IFRS. Usually such

amalgamation is done as part of reconstruction of a loss making company and hence reconstructions also is included while considering amalgamation.)

The Uses of a Scheme

Many jurisdictions contain explicit statutory merger procedures, whereby one company can transfer its assets and liabilities to another or two or more companies can transfer their assets and liabilities to a third, often newly created company, subject to consent of the directors and, usually, of the shareholders of the companies involved and, sometimes, of a court. As indicated, the British Act apparently contains no such mechanism. However, s. 425 of Indian Companies Act provides that, subject to the consent of the shareholders and of the court, a company may put into effect 'a compromise or arrangement between the company and its members of any class of them'. This wording appears to be aimed at a restructuring of the mutual rights and obligations of the members and the company, i.e. to be confined to the affairs of a single company. The procedure can indeed be used in this way, as is indicated by the definition of 'arrangement', which is expressly stated to include a reorganization of the company's share capital by the consolidation of shares of different classes or by the division of shares into shares of different classes or by both (Sec.56).However, that the procedure can be used for the amalgamation of two or more companies is made clear by sec.177(7) which deals specifically with compromises or arrangements under sec.177(3)(f) proposed for the purpose of or in connection with the reconstruction of any company or companies, or the amalgamation of two or more companies. An appropriately drafted scheme can also be used to produce the same effect as a takeover offer, i.e. the offeror and target do not merge, but the latter becomes a subsidiary of the former. Indeed, the courts have construed 'arrangement' as a word of very wide import covering almost every type of legal transaction so long as there is some element of give and take and has the approval of the company (or companies) concerned, either through its board or through the members in general meeting.

An advantage of the scheme is that it becomes binding on all the shareholders in question if approved by three quarters of the shares (and a majority in number of them), a crucial step in this reasoning is that the court must form its own judgment on the merits of the scheme when it comes to consider its approval and not grant approval simply because the appropriate proportion of the members have approved it.

Sec. 177(1) of Companies Act, 2063 provides for amalgamation of a public company into another company for which the former company shall pass a special resolution for amalgamation with the other company and they must apply to OCR for approval within 30 days of the passing of resolution giving the various details.

In the case of amalgamation of private companies, the same shall be governed by the provisions in the Memorandum of Association, the Articles of Association and the unanimous agreement.

If a public company is merged into a private company or a private company is merged into a public company, the resulting company will be a public company only. But, if two private companies merge into the other, the resulting company shall be a private company.

It may happen sometime that three or four companies are amalgamated into a single company or various subsidiary companies amalgamated with the holding company.

The details to be submitted to the OCR in connection with the amalgamation are given in Sec. 177(3)

(1) In the case of public company, the special resolution passed by the company and in the case of private company, copy of Memorandum of Association, Articles of Association or the unanimous agreement which gives authority to amalgamate with another company.
(2) The latest balance sheet of the amalgamating company along with the auditor's report there on.
(3) Consent letters in writing of the creditors of the amalgamating companies. If there are many creditors, it will be difficult to get individual consent. The practical way is to call a meeting of the creditors just like a shareholders general meeting giving notice in the national newspaper and pass a resolution of consent at the meeting where the creditors holding 90% of the liabilities agree to the amalgamation, it should be sufficient. Major creditors will be banks who have lent money and their individual permission can be taken.
(4) Valuation of the assets both movable and immovable, if the amalgamating company and the true position of the assets and liabilities. There may be certain liabilities which can come into existence on the occasion of amalgamation like terms in financial lease for compensation and termination in case of change of ownership will have to be taken into account.
(5) If any decision has been taken by the amalgamating companies regarding the creditors and employees and workers of the amalgamating company, then a copy of such decision shall be submitted. This will be normally spelt out in the scheme of arrangement.
(6) The scheme of arrangement entered into between the amalgamating companies laying down the various terms and conditions to be complied with in the course of amalgamation at various stages.

On receipt of the application for amalgamation at ROC, after making the study relating to it, OCR will intimate its decision within three months from the date of receipt of application. ROC decision can be approval of the scheme or refusal to give approval or approval subject to certain condition.

On receipt of approval from OCR for amalgamation, all the assets and liabilities of the amalgamating company will be deemed to have been transferred to the amalgamated company without any further action. For any change of name relating to any property or deposits etc with any government department, the approval of OCR is sufficient and on production of the same, Land Revenue Office or Inland Revenue office shall make change the name in their record. OCR has to maintain a separate register to record the details of such amalgamating company in the register of Companies maintained by them.

Sec. 177(7) provides for the relief of dissenting shareholders. This deals with a sort of reorganization. But this section apart from amalgamation provides for other cases also for dissenting shareholders as follows:

(a) Consolidation of company;
(b) Amalgamation of company;
(c) Variation of the rights of shares;
(d) Transfer of property;
(e) Sale of the whole of the company's properties.

If any shareholder does not give his assent in writing to any of the above things, he can get the amount in proportion to the shares he holds from the amalgamating company after valuation of the assets of the company before such consolidation, amalgamation or variation in the rights of shares or transfer or sale of the property.

The shareholder should give his dissenting vote while passing the special resolution for consolidation or amalgamation or variation in the rights of shares or transfer or sale of property.

Here the dissenting shareholder is prevented from going to the court and his relief is provided in the Act. But if he smells any fraud or bad faith in the valuation of the assets then he may be able to go to the court on that point. But no instant relief is provided in the Act in case of any fraudulent act in the course of valuation of the assets.

But apart from considering the merits in the scheme of amalgamation or the variation in the rights of shareholders, OCR will have to refuse the amalgamation, if ROC considers such amalgamation results in:
(a) Monopoly;
(b) Improper control of the trade and business or
(c) Against the public interest.

While merger of a company not distributing profit with another company not distributing profit, all provisions of this section shall be applied with respect to necessary modifications *(mutatis mutandis)*.

In England and India, such scheme has to be approved by courts. But this provision has short circuited the court to ROC itself. Only when the companies or shareholders find that the refusal or approval of the scheme by ROC was wrong or fraud on the shareholder and creditors, the matter can be taken up on appeal to the Appellate Court which is the designated company court at present.

In England also the Company Law Reform (CLR) Committee considered whether the approval of the Court can be done away with at the initial level by a statutory procedure as followed in Nepal by the present Act. According to CLR, no approval of Court is necessarily and merely the resolution of the two companies is sufficient to effect the merger. But it came to the conclusion that where the third and sixth Directives of EEC applied, it would be impractical to implement a proposal except under the supervision of the Court. Further the problem of third party rights and creditor protection was that the statutory merger procedure seemed feasible in two cases, namely,

(a) Where the wholly owed subsidiaries are merged with the holding company;
(b) Where a company found a new wholly owed subsidiary into which the assets and liabilities of an existing company were transferred and the transferor is dissolved or say merged with the transferee.

CLR considered, in the former case above, that merger should be effected by the decisions of the director of the companies instead and to protect creditors, a solvency declaration by the directors, notice to the creditors and a right for dissenting creditors to apply to the court for relief should be sufficient.

18 KINDS OF COMPANIES

In this chapter, we shall study the legal provisions relating to the following companies:

1. Holding and Subsidiary company
2. Special provisions for private companies
3. Single shareholder company
4. Foreign Company
5. Defunct Companies
6. Company not Distributing Profit

HOLDING COMPANY & SUBSIDIARY COMPANY

Where one company has control over another, it is known as the holding company and the company over which control is exercised is called the subsidiary company. This control of one company over another may be held in one of the following three ways: [Sec. 2 (d) & (e)]

Firstly, under Sec.142 (1), where one company controls the composition of the Board of Directors of another directly or indirectly, the latter becomes the subsidiary of the former. The fact that the majority of directors will remain on the Board only up to the next annual meeting is not material. The relationship of holding and subsidiary is established at least for the time being. M. Velayudhan v Registrar of Companies, [(1980) 50 Comp Cas 33 Ker.] The composition of the Board of directors of a company shall be deemed to be controlled by another if the latter has the power, without the consent or concurrence of any other person, to appoint or remove the holders of all or a majority of the directorship. And a company shall be deemed to have the power to appoint to a directorship in the following three cases:

(a) If a person cannot be appointed to a directorship without the exercise in his favour of the power of appointment held by the company.
(b) If a person‘s appointment to directorship follows necessarily from his appointment as director, managing agent or manger or to other office of employment in the company.
(c) If the directorship is held by an individual nominated by the company or by any of its subsidiaries.

Secondly, where one company holds the majority of shares in another company, the latter becomes the subsidiary of the former. In ordinary cases, ‘majority shareholding’ means holding more than half units of allotted equity share capital of a company.

Thirdly, where one company is subsidiary of another, which is itself a subsidiary of some other company, the first mentioned company shall also become the subsidiary of the last mentioned company. Following example will illustrate the point: [Sec.142(2)]

Company 'B' is a subsidiary of Company 'A', and Company 'C' is a subsidiary of Company 'B'. The, Company 'C' also becomes a subsidiary of Company 'A'. If Company 'D' is a subsidiary of Company 'C', Company 'D' will be subsidiary of Company 'B' and consequently also of Company 'A' and so on.

The above conditions will be deemed to have been satisfied, even if the majority of shares are held or the power of appointment to directorship is exercisable by any person as a nominee of the holding company or as a nominee of any of its subsidiaries [Sec.142 (3)]. But in determining whether one company is a subsidiary of another, shares held or power exercisable in the following three cases shall be disregarded:

(a) Where the shares are held or the power is exercisable by the company in a fiduciary capacity.
(b) Where the shares are held or the power is exercisable by any person by virtue of the provisions of any debentures or of a trust deed for securing any issue of such debentures.
(c) Where the shares are held or the power is exercisable by a lending company by way of security and only for purposes of a transaction entered into in the ordinary course of business.

Involvement of Sec. 176(1)

Investment by one company in the shares of another company to the extent of majority shareholding comes into conflict with the restrictions on inter-corporate investments envisaged under Sec.176 (1). That is why the proviso to Sec. 176(1) exempts a holding company from the operation of the section and makes it free to invest any amount in the shares of its wholly owned subsidiary. But, at the time when first investment takes place beyond the limits of S. 176(1), the investee company is not a subsidiary. It would become subsidiary only after the investment. If the investment is within the limits of S. 176(1) and that investment itself gives a majority status to the investing company, the formalities and approvals prescribed by S.176(1) would not apply. Where the investment goes beyond those limits, a special resolution would be necessary. After thus gaining the status of a holding company, Section 176(1) would not apply on investments in the subsidiary. The exemption from the operation of S.176 (1) is not available to a Board controlled subsidiary.

Accounts of Holding Company

Section 143 contains special provisions about holding and subsidiary companies. Section 143 provides that 'there shall be attached the balance sheet of a holding company the following documents in respect of each subsidiary:

(a) A copy of the balance sheet of the subsidiary. The balance sheet must be made out in accordance with the requirements of the Act as at the end of the financial year of the subsidiary.

(b) A copy of the profit and loss account of the subsidiary prepared in accordance with the provisions of the Act for the same period.
(c) A copy of the report of its board of directors made out in accordance with the requirements of the Act and for the period referred to above.
(d) A copy of the report of its auditors.
(e) A statement of the holding company's interest in the subsidiary at the end of the financial year. The statement shall specify the net aggregate of the subsidiary's profits after deducting its losses at the end of the financial year and also for the financial years since it became a subsidiary, but only so far as it concerns, the shareholders of the holding company and is not dealt with in the company's accounts. If the profits of the subsidiary are dealt within the holding company's accounts or a provision is made for any losses, the net aggregate amount of the same must be disclosed. This will be necessary only for such profits and losses of the subsidiary which may properly be treated in the holding company's accounts as revenue profits or losses.
(f) If, for any reason, the board of directors of the holding company is unable to obtain information on any of the above matters, a report in writing to that effect must be attached to the balance sheet of the holding company. [Sec.143 (3)]
(g) Where the financial year of the subsidiary does not coincide with the financial year of the holding company a statement has to be attached showing any change in the holding company's interest in the subsidiary taking place between the gap of the two companies financial years. The statement must disclose the details of the material changes in the subsidiary's fixed assets, its investments, the moneys lent by it, the moneys borrowed by it for any purpose other than that of meeting current liabilities. [Sec.143 (1) (d)]

Investment in Holding Company (Sec. 144)

A subsidiary company is not allowed to acquire shares or debentures of the holding company or make investment in the holding company in other manner. Consequently, any allotment or transfer of shares in a company to its subsidiary shall be void.
The section does not apply to the following cases:

(a) Where the subsidiary is concerned as a legal representative of a deceased member of the holding company.
(b) Where the subsidiary is concerned as a trustee. This exception will not apply where the holding company itself or any of its other subsidiaries is beneficially interested under the trust, except when its interest is only for the purpose of a security for a transaction, including lending of money, entered into in the ordinary course of business.

A subsidiary can buy shares in its holding company where it is a part of a scheme of amalgamation sanctioned by the court. [*Himachal Telematics Ltd v Himachal Futuristic Communications Ltd*, (1996) 86 Comp Cas 325 Del].

A company, its managing director or manager or any other director or directors may together hold the whole or most of the shares in another company in such manner that they hold in total more than half in nominal value of its equity share, then the other company will not be technically a subsidiary of the company and can avoid the attachment of Balance Sheet etc. to

the accounts of the company. Further this will enable the other company to hold shares in the company.

SPECIAL PROVISIONS RELATING TO PRIVATE COMPANY

A private company may make following arrangements by a unanimous/consensus agreement between the shareholders in addition to the provision of Articles of Association of the Company. The matters that can be contained in such unanimous agreement are listed below:

Unanimous Agreement (Sec. 145)

Except when otherwise provided for in this Act, a unanimous agreement of a private Company may provide for the following matters:

(a) Management, business and transactions of the Company;
(b) Restriction, if any, on the transfer of shares;
(c) Right of one or more shareholders to dissolve the Company voluntarily or on the ground of any specific or extraordinary event.
(d) Division or exercise of the right to vote;
(e) Conditions of appointment of office-bearers, employees and workers of the Company;
(f) Identification of the Director, office-bearer or person shouldering the final responsibility, or the Executive Chief of the Company;
(g) Procedure of paying dividends or sharing profits;
(h) Provision that there shall be no Board of Directors;
(i) If, no Board of Directors is to be formed, identification of the person who is to discharge the functions to be discharged by the Board of Directors under this Act;
(j) In case no Annual General Meeting is to be held, provisions concerning the same;
(k) Categories of shares, and details of the provisions made for shares with different rights, if any; Matter related to company operation, management, voting right to shareholders or other special facilities, right or interrelation among shareholders.

The unanimous agreement may be amended by consent in writing of all the parties to the agreement. After the unanimous agreement has been entered, any person acquiring shares in the following manner shall be deemed to have consented to the agreement and a party to the agreement [Sec.145 (3)]

(a) If the shares are acquired as gift;
(b) If the shares are acquired in any other way, and at the time of acquiring the shares he has knowledge of the existence of unanimous agreement.

Sec. 146 entitles the shareholder of a private company or his representative to inspect during office hours the following documents related to the business of the company:

(a) Minutes book of general meetings and the Directors meeting;
(b) Annual financial statements;
(c) Shareholders Register;
(d) Accounts of the Company.

The directors or other officer of the company should make adequate arrangements to enable the shareholders to inspect the books and records.

Shareholder of a private company may demand the details of transactions of the company. On receiving such application, the details including the annual financial statements duly certified by the director, managing director or any officer of the company shall be provided within fifteen days.

It may be noted that in the case of a public company, a shareholder has no right to inspect any of the above except the shareholders register, minutes of the general meeting and the annual financial statements.

Not Necessary to Hold Annual General Meeting (Sec. 148)

If the unanimous agreement between the shareholders provides for not holding the annual general meeting, during the currency of the agreement, no annual general meeting need be held by such private company.

If the unanimous agreement has provided for not holding the annual general meeting, then it must provide for the manner in which the matters to be decided at the annual general meeting has to be decided and how it is to be authenticated.

Private Company to Adopt Written Resolutions (Sec. 149)

(1) Notwithstanding anything contained elsewhere in this Act, any function which may be performed through the adoption of a special or any other resolution by the General Meeting of a private Company, or by a meeting of its shareholders of any particular category, may be performed on the basis of a written resolution signed by all such shareholders as are entitled to vote in the course of discussing the resolution, on the very date when the resolution is to be deemed to have been adopted, unless otherwise provided for in the articles of association.

(2) In case separate written resolutions have been recorded for any reason for the purpose of Sub-Section (1), and in case the contents of all such documents are similar in nature, it shall not be mandatory for all the shareholders to sign the same documents; they shall be deemed to have signed the same document even if they have signed separate documents, and such documents shall be held to be valid.

(3) Every shareholder affixing his signature on any written resolution under this Section must explicitly mention the date on which he did so. The latest date on which a shareholder has affixed his signature on the resolution shall be recognised as the date of adoption of the resolution.

(4) Any document attached to any written resolution shall be recognised as having been presented before a meeting of the shareholders who have affixed their signatures on the resolution.

(5) Every resolution adopted under this Section shall be recognised for all purposes as equivalent to any resolution adopted by a General Meeting of the Company or a meeting of the shareholders belonging to any particulars group.

Recognition as Participation in General Meeting (Sec. 150)

(1) Notwithstanding anything contained elsewhere in this Act, in case any shareholder of a private Company uses any means of communication to establish a communication-contact with all other shareholders, and in case all shareholders participate in the communication contact in such a manner that the words spoken by every shareholder can be heard or read by the other shareholders, every shareholder participating in such a communication contact shall be deemed to have participated in the General Meeting together with the other shareholders, unless otherwise provided for in the Articles of Association.
(2) Notwithstanding anything contained elsewhere in this Section, in case any shareholder, within three months after the General Meeting is held, files a petition to the Office, along with the prescribed fee, claiming that he had not participated in that General Meeting, the Office must examine the concerned Company with respect to the matter. In case the Company fails in the course of such examination to prove that the petitioner shareholder had participated in the concerned meeting, the decisions made by the meting shall not be held to be valid.
(3) Any meeting of shareholders held in the manner mentioned in Sub-Section (1) shall be deemed to have been held at the place where the Chairman of the meeting was present.
(4) The provisions contained in Sub-Section (1), (2) or (3) which are valid with respect to the General Meeting of the Company shall also be applicable to the meetings of the Directors of the Company or the meetings of the Sub-Committee of such Directors with necessary changes.
(5) After holding a General Meeting in the manner mentioned in Sub-Section (1), the minutes of its proceedings and decisions shall be prepared on an annual basis and certified by the Chairman of the meeting.

PROVISION RELATING TO SINGLE SHAREHOLDER COMPANY

Companies Act, 2063 has made a separate special provision for single shareholder companies under its Chapter-15.

In the case of single shareholder companies, holding of annual general meeting and Board meeting is necessary only if it is expressly provided in Article. However, still the minutes are to be prepared and signed by the single shareholder. Notwithstanding anything provided in the Act, in the case of single shareholder company, unless the Articles provides otherwise, all matters to be decided by the Board Meeting or the General Meeting of the company, shall be decided in writing under the hand of the single shareholder, and for that purpose it is not necessary to call the Board Meeting or the General Meeting.

Transfer of shares of Single Shareholder Company (Sec.153)

In case of death of the shareholder (the only shareholder) of the single shareholder company, then his heir shall get the interest in the shares held and he can do all the things that the single shareholder company can under the Act including the transfer of shares. Such person shall make a written document for the transfer of shares duly signed by him.

But, if no legal representative could be located, then the OCR may appoint a liquidator and wind up the company as per the provision of the law.

The person deriving interest in the shares of single shareholder Company on the death of the shareholder shall inform the OCR within one month of acquiring the interest with necessary evidence.

On receipt of such information, the OCR shall take in record of the same against the prescribed charges and shall give the person intimation regarding the ownership of the shares.

If such heirs are more than one, unless the heirs give authority to transfer the shares in the name of one heir, all the heirs will be treated to have become directors for the time being and the Memorandum or Articles of Association shall be amended to change the company from single shareholder company to normal several shareholders company with 2 or more shareholders.

Where dispute arises as to the right to interest the shares, the same shall be decided by the Court, and further action shall be according to that decision as to whether Court decides on one person or on 2 or more persons.

FOREIGN COMPANIES

As per section 2(f) of Companies Act 2063, foreign company means a company incorporated outside Nepal. A foreign company though incorporated outside Nepal, may have a place of business in Nepal. The meaning of the expression 'the place of business' has been judicially constructed. The court in India considered the extent of business which has to be carried on to make 'a place of business' for the purpose, in that case, to establish a sufficient presence within the jurisdiction for service of process. [*A.S. Dampskib 'Hercules v Grand Trunk Pacific Rly Co*, (1912) 1 KB 222]. A Canadian railway company's four directors were in England who formed a London Committee for the purpose of raising loans for the construction of the railway in Canada. They were using the office of another company without rent and transacted no other business than that of raising loans. The Court of Appeal held that the defendants were carrying on their business in the office used by the London Committee and could therefore be properly served with a writ. In the pictorial words of BUCKLEY LJ: [At p 223,ibid].

We have only to see whether the corporation is 'here', if it is, it can be served. The best test is to ascertain whether the business is carried on here and at a defined place. In the present case the company has paramount, and also a subsidiary object: its paramount object is to make and run a railway in Canada, to do which a great many things must first happen; it has a subsidiary object, namely, the raising of money to carry out its paramount object. The raising of this loan capital is part of the company's business, and it is done here by a London Committee constituted of the directors resident in England.

Similarly, where an overseas bank hired premises in England had some staff there for the purpose of conduct of external trade and financial relations that was held to be a place of business, though no actual banking transaction was taken up there. A company established no office in England, but enlisted 5000 residents in the UK as members of its Titan Business Club so as to enable them to earn by chain system. This was held to be sufficient to give jurisdiction to the English courts to entertain a petition for winding up a foreign company.The company's employees were restrained from remitting any funds to Germany. But where a foreign company posted a representative in India only for the purpose of eliciting orders from the company's customers that was held to be not establishing a place of business in India. The court said that

there should be a fixed and definite place where the business-like operations are carried on for a reasonably long period of time.

Establishing a Place of Business

It has been held in a Scottish case [Lord Advocate v Huron and Erie Loan and Saving Co., 1911 612] that 'a company incorporated outside the United Kingdom which employs agents, within the United Kingdom, but has no office here does not establish a place of business within the United Kingdom' within the meaning of this section. [Buckley Companies Act, 12th Edn, page 744]

A foreign company shall be establishing a place of business in Nepal, if it has a specified or identifiable place at which it carries on business, such as an office, store house, godown or other premises having some concrete connection between the locality and its business. The word 'establish' indicates more than occasional connection.

Having a share transfer office or share registration office will constitute 'establishing a place of business' See Employee's Liability Assurance Corporation v Sedgwick, Collins Co. 1927 Appeal Cases 95; see also The Madrid, (1937) 1 All E.R. 216. In another case the Court went to the length of holding that where representative of a foreign company were often comingand staying in a hotel in England for purchasing machinery, cotton, etc. the foreign company had a place of business in England, *Tovarishesto Manufacture Liudvigv Rabenek,* [(1944) 2 All E. R. 556]

As per the corporation laws of several States in U.S.A. the following activities do not constitute 'carrying on of business':

(a) Maintaining or defending any suit or action or other proceeding or effecting the settlement of any claim or dispute;
(b) Holding meetings of shareholders or directors;
(c) Maintaining bank accounts;
(d) Maintaining offices or agencies for the transfer, exchange and registration of shares or other securities;
(e) Effecting sales through independent contractors;
(f) Soliciting or procuring orders where such orders require acceptance outside the State for becoming binding contracts;
(g) Creating evidences of debts, charges on real or personal property;
(h) Securing or collecting debts or enforcing claims to property of any kind;
(i) Conducting any isolated transaction.

What has to be shown in every case is that the business which was carried on at the relevant location was the business of the company itself [*Mitchnet plc v Williams Blair & Co. LLC,* (2003) 2 BCLC 195 ChD.]

Registering of Foreign Companies (Sec. 154)

(1) A foreign Company shall not operate any business or enterprise or open a liaison office within Nepal without having itself registered at the OCR under this Section. However, no

act of making investments in the shares of any Company established according to law, or of supplying loans to or participating in the operation or management of any such Company, with the approval of the competent authority shall be deemed to be a business or enterprise for the purposes of this Chapter.

Explanation: For the purposes of this Chapter, a foreign Company shall be deemed to have operated its business or established its office in Nepal if it regularly operates any business, or appoints or acquires the services of any person for regular contacts, for a month or any period exceeding that from any office established or from any office or place used for the purpose in Nepal.

(2) A foreign company desiring to have its branch office registered pursuant to Sub-section (1) shall make to the Office an application, accompanied by the permission obtained from the concerned body pursuant to the prevailing law, and the prescribed fees and in such format as prescribed, for the registration of such company.

(3) Any foreign Company desirous of operating any enterprise or business or establishing a liaison office as mentioned in Sub-Section (1) must submit an application to the ROC Office in the prescribed form for registration, along with the prescribed fee and the approval obtained for the purpose from the concerned body under current law. (But what approval from which department or authority should be obtained is not spelt out anywhere]

(4) On receipt of an application for the registration of a foreign Company under Sub- Section (2) or (3), the Office shall conduct necessary inquiries and investigations and register the Company for the purpose of operating its business or enterprise or establishing its liaison office in Nepal, and issue it with a certificate of registration as prescribed within 30 days from the date of application.

(5) In case any foreign Company cannot be registered as per the application filed under Sub-Section (2), the Office must furnish information thereof to the concerned applicant within 30 days by explicitly mentioning the reasons there for.

(6) A foreign Company registered under Sub-Section (3) may establish a liaison office, or open a branch office and operate its business or enterprise, within Nepal. However, a foreign Company registered as a liaison office may not undertake any income-earning activities within Nepal.

(7) In case the name of a foreign Company submitting an application under Sub-Section (2), or the nature of the objective to be implemented by it is such that it cannot be registered under this Act, the foreign Company cannot be registered in Nepal.

(8) A foreign Company registered under Sub-Section (3) shall be deemed to have been registered subject to the condition that it may operate (in Nepal) only the type of business or enterprise that it is operating in the country where its registered office is located or where it has been established.

(9) A foreign Company registered under this Section must keep its sign board at the place of its business in a conspicuous manner. The name of the country of its establishment and the registration number under which it has been registered in Nepal must be explicitly mentioned in the sign - board and the bills, receipts or letter pads to be used by it.

(10) For the purpose of registering foreign companies to be registered under this Section, the OCR shall keep a separate register. The Office must make arrangements to enable the public to inspect the register and obtain a copy thereof on payment of the prescribed fee.

(11) Notwithstanding anything contained elsewhere in this Act, a foreign Company registered under this Section may not issue shares or debentures inside Nepal.
(12) Notwithstanding anything contained elsewhere in this Section, a foreign Company which is operating any business or enterprise or which has established its liaison office inside Nepal without having the same registered in Nepal at the time of the commencement of this Act must register itself at the Office under this Act within six months after the commencement of this Act.

Submition of Documents by Foreign Companies (Sec. 155)

A foreign Company applying for being registered or establishing a liaison office under Section 154 must submit to the OCR the following documents along with the application:

(a) Permission obtained by the foreign Company from the competent authority to operate its business or enterprise in Nepal.
(b) Photo copies of the charter and certificates of the establishment of the Company and its Memorandum and Articles of Association, along with their Nepali translations.
(c) Statements containing the full names and addresses of the head office and the main place of business of the Company, the date of establishment of the Company, and the issued capital and the main objectives of the Company.
(d) Name, address and nationality of the Director, Manager, Company Secretary or the Chief Office-Bearer of the Company.
(e) Name and address of a person residing in Nepal who has been authorized by the Company to receive the summonses, notices, etc., to be issued in the name of the Company.
(f) The main place from where the Company is to operate its business or enterprise in Nepal, and the full address of the office of the Company located therein.
(g) If the Company is to operate its business or enterprise inside Nepal, particulars of the proposed investment and business.
(h) If the Company is to commence its business in Nepal, the proposed date thereof.
(i) A declaration made by the Company Director or his representative on behalf of the Company to the effect that the contents of the statements submitted by the Company are true and correct.
(j) The authorization letter mentioned in Section 157.

In case any of the matters mentioned in any of the documents submitted by a foreign Company as mentioned above is amended or changed, information thereof must be furnished to the Office within 35 days along with the details of such amendments or changes.

All documents of foreign origin or the copies thereof, to be submitted as above must be submitted after having them certified according to the law of the country where the foreign Company is registered.

It should be certified either by the registering authority in the foreign country or a notary public as per the laws of the respective country.

A foreign company is further bound by the following obligations:

(a) The company shall conspicuously exhibit on the outside of every office or place of business its name and the country of incorporation in English characters and in the regional language. The statement must also show whether the liability of the shareholders is limited.
(b) The name and the country of incorporation should also appear in English on all business letters, bill-heads and letter papers and on all notices and other official publications of the company. The statement must also indicate whether the liability of the shareholders is limited.

A failure to comply with the above provisions does not affect the validity of any contract made by a foreign company, but 'the company shall not been titled to bring anysuit, claim any set-off, make any counter-claim or institute any legal proceeding in respect of any such contract until it has complied with all the provisions of the Act relating to foreign companies'.

Accounts, Records, Audit, and Annual Reports of Foreign Companies (Sec.156)

(1) Every foreign Company registered under Section 154 shall, like every other Company established under this Act, prepare its Annual Financial Statements, including the Balance Sheet and the Profit & Loss Account, in such a manner as to clearly depict the actual condition of its business in Nepal, have them audited, and submit them to the Office within six months after the expiry of each financial year.
(2) A foreign Company shall submit to the Office copies of the Annual Financial Statements and reports of the auditor and the Directors Report prepared for each Financial Year according to the law of the country where its registered office is located, within three months from the date of final preparation there of.
(3) A foreign Company shall include the following particulars also while preparing its Annual Financial Statements under Sub-Section(1):
    (a) A statement prepared by classifying and showing separately the movable, immovable and other assets of the foreign Company in Nepal.
    (b) A clear statement of the cash deposits of the foreign Company in the banks and financial institutions located in Nepal.
    (c) A statement pertaining to loans and overdraft obtained, if any, by the foreign Company from the banks and Financial Institutions located in Nepal.
    (d) Total amount of the loans and liabilities to be repaid, if any, by the foreign Company to any resident person of Nepal or to any Nepali Company registered under this Act.
(4) In case any report or statement to be submitted to the Office under Sub-Section (2) and any document to be attached thereto is written in any language other than Nepali or English, its officially translated Nepali or English version must also be submitted.
(5) A foreign Company having its liaison office in Nepal registered under Section 154 shall submit to the Office within three months after the expiry of each Financial Year a statement pertaining to the employees, advisors or the contact person working in the liaison office and the remuneration, allowances and other amounts paid to them, a statement pertaining to the deduction of tax made from such payments according to current law, a statement pertaining to the payments made as rent and other expenses for running the office, and a statement of the deduction of tax made from such payments according to current law, after having them certified by the auditor.

But how many copies of the accounts should be submitted is not mentioned. In India, three sets of accounts have to be submitted by a foreign company. But nowadays all the accounts have to be submitted through electronic media only in India.

Authorization Letter (Sec .157)

A foreign Company to be registered under Section 154 shall submit to the Office a copy of the authoritative letter of appointment of a resident of Nepal as its authorized representative in Nepal, prepared in the prescribed form and by fulfilling the formalities laid down in the law of the country where the Company is established or where its head office is located and authorizing him to receive summonses or notices regarding lawsuits or other legal proceeding initiated by or against the Company or other notices conforming to law.

The authorization letter issued above must contain, among other things, a statement to the effect that any summons or notice relating to any lawsuit to be initiated by or against the Company, or any other legal notice delivered to the authorized representative shall be binding on the Company for all purposes.

This authorization letter may be in the form a Power of Attorney executed in favour of the representative in accordance with the laws of the country in which the company is incorporated or may be a certified copy of the Board resolution of the foreign company giving the authority.

Cancellation of Registration and Liquidation of Foreign Companies (Sec. 158)

(1) In case any foreign Company registered under Section 154 wishes to close down its business in Nepal and have its registration cancelled, or in case the competent authority under current law prohibits any such Company from operating its business or enterprise in Nepal, the Company must submit an application to the Office along with the prescribed fee for having its registration cancelled.

(2) A foreign Company submitting an application under Sub-Section (1) must submit along with the application all such evidence as are necessary to determine that it has no liability to be paid to any individual, institution or governmental or non-governmental body in Nepal.

(3) For the purpose of ascertaining whether or not the evidence submitted under Sub- Section (2) is true, the Office shall publish a notice in national dailies at least twice, calling on anyone with any liability due from the Company to put in a claim for the same within 21 days along with evidence.

(4) In case anyone files a claim in response to the notice published under Sub-Section (3), the concerned Company must submit to the Office evidence of (settlement of) the claim. In case any claim made against the concerned Company under Sub-Section (3) cannot be settled from its assets located in Nepal, the same shall be settled from its assets located outside Nepal.

(5) In case no claim is filed within the time-limit mentioned in Sub-Section (3), or in case evidence of the settlement of any claim so made is submitted under Sub-Section (4), the Office shall remove the name of the Company from the Register of Foreign Companies and furnish information thereof to the Company.

(6) In case insolvency proceedings against any foreign Company registered in Nepal under this Chapter are started according to the law of any of the countries where the foreign Company is operating its business, the representative of the Company authorized under Section 157 must forthwith furnish information thereof to the Office in writing, and also publish a notice thereof in national dailies for the information of the public. However, the concerned foreign Company must close down its business in Nepal in case the order canceling its registration has already been issued.

(7) In case any foreign company has closed down its business or enterprise as mentioned in the restrictive clause of Sub-Section (6), action in respect to the business or enterprise operated by the Company in Nepal shall be taken in accordance with the current law relating to insolvency.

When any change occurs in the above particulars, the Registrar shall be notified accordingly.

Accounts of Foreign Company

The obligations of a foreign company in respect of accounts are almost the same as those of a company incorporated under the Companies Act, 2063. Section 156 provides that 'every foreign company shall in every financial year make out a balance-sheet and profit and loss account in such form, containing such particulars, including such documents as, under the provisions of this Act it would, if it had been a company within the meaning of this Act, have been required to make out and lay before the company in a general meeting and deliver three copies of these documents to the Registrar'. Separate balance-sheet and profit and loss account in respect of the company's Nepal business should be prepared and submitted along with a copy of the company's world business. Copies of the accounts have to be filed with the Registrar.

Section 156(5) requires a foreign company to maintain books of account 'with respect to moneys received and expended, sales and purchases made and liabilities in the course of, or in relation to its business in Nepal'.

DEFUNCT COMPANIES

Power of the Office to Cancel Registration (Sec. 136)

(1) The Office may cancel the registration of a Company in the following circumstances:
   (a) In case the promoters of the Company submit an application along with the prescribed fee for the cancellation of its registration on the ground of the failure to commence its business;
   (b) In case the Company fails to submit the statements to be submitted under Section 80 or in case the Company fails to pay the fine payable under Section 81 for not filing the documents to be filed for three consecutive Fiscal Year,; or
   (c) In case there are reasonable grounds for the Office to believe on the basis of evidence received in the course of Company administration that the company has not commenced its business, or that the Company is not in operation.

(2) In case it becomes necessary to cancel the registration of a Company under Sub-Section (1), the Office shall furnish a notice thereof to the Company explaining the reasons there for before canceling its registration.

(3) The notice to be sent to the Company under Sub-Section (2) shall be sent to its registered office, or, if the address of the registered office of the Company is not registered at the Office, or if the Company has no office at the registered address, to an officer of the Company, and, if the address of any such officer is not available with the Office, or if the Office fails to locate the address, to the address of each of the promoters mentioned in the Memorandum of Association of the Company.
(4) The notice sent under Sub-Section (2) shall also be published in national daily newspaper according to need.
(5) In case the Company does not submit within two months after it receives a notice under Sub-Section (2), an application explaining the reason why its registration shall not be cancelled, or in case the reason cited in the application submitted by it is found to be inappropriate, the registration of the Company may be cancelled.
(6) In case the registration of a Company is cancelled under Sub-Section (5), a notice thereof shall be sent to the concerned Directors, and also published in daily newspaper.
(7) In case the registration of a Company is cancelled under Sub-Section (5), its officers or shareholders shall continue to be liable for the obligations of the Company, if any, and nothing contained in this Section shall be deemed to have prejudiced the right to initiate necessary legal action against them to have such obligations fulfilled.
(8) All assets, rights, facilities or obligations existing in the name of the Company at the time of the cancellation of its registration under Sub-Section (5) shall devolve on the shareholders in proportion to the shares held by them. However, no asset held by the Company as a trustee of any person shall come under the title and ownership of the shareholders.
(9) In case loans or liabilities to be settled by a Company whose registration has been cancelled under this Section cannot be settled from the extent of the assets, rights or facilities received by the shareholders under Sub-Section (8), the outstanding loans or liabilities shall be personally borne by the shareholders, Directors or officers involved in the management of the Company and responsible, directly or otherwise, for causing the emergence of the circumstances mentioned in Sub-Section (1).
(10) No Company whose registration has been cancelled under this Section may conduct any business under the name of the same Company.

Special Provision Relating to Cancellation of Registration (Sec. 136A)

The first amendment in Companies Act, 2063 published on 2074/1/19 introduced special provision relating to cancellation of registration as follows:

(1) Notwithstanding anything contained elsewhere in this act, the company not commencing the business or not in operation on or before the commencement of this section, company not filing returns under section 80 or the company not paying penalty under section 81, if wants to cancel the registration within 2 years of commencement of this section, such company shall make decision from general meeting and may apply to the OCR in the prescribed form.
(2) Along with application under sub-section (1), return details under section 80 and penalty under section 81 or 0.5% of paid up share capital whichever is lower shall be submitted.
(3) On receipt of application as per sub-section (1), the office may cancel the registration of such company following the provisions of section 136.
(4) The provisions related to liabilities of the company whose registration has been cancelled as per this section will be according to the section 136.

Revival of Registration of a Company Whose Registration has Been Cancelled

(1) In case a petition is submitted to the court by any Company whose registration has been cancelled under Sub-Section (5) of Section 136, or by its shareholders or creditors for having the Company revived within five years from the date of publication of the notice of the cancellation of the (registration of the) Company explicitly mentioning the reasons there for, the court may, in the following circumstances, issue an order to revive the Company and re-record its name in the Company Register:
   (a) In case it is found that the registration of the Company had been cancelled at a time when it was operating its business.
   (b) In cases the court deems it justified to revive the name of the Company in order to make appropriate arrangements for its assets and liabilities.

(2) In case any Company is revived through a court order as mentioned in Sub-Section (1), the Company shall be deemed to be in existence ever since the date of its registration.

(3) While issuing an order under Sub-Section (1), the court may also issue an order deemed appropriate by it for restoring the situation that prevailed before the cancellation of the registration of the Company in relation to the Company and all other persons, as well as for making necessary arrangements for the purpose.

(4) In case a Company is revived under Sub-Section (1), the Company shall be revived and its name re-recorded in the Company register only after the Company pays the fine payable by it under Section 81.

(5) In case any Company is revived under this Section, the Company shall get back the following assets:
   (a) Assets acquired by the shareholders of the Company under Sub-Section (8) of Section 136 on the ground of the cancellation of the registration of the Company.
   (b) In case the assets mentioned in Clause (a) have already been sold, the amount received at the time of the sale.

However, no assets or amount that has been spent to settle the creditors' loans or liabilities shall be liable to be refunded.

But the liability, if any, of every director, or other officer who was exercising any power of management and of every member of the company shall continue and may be enforced as if the company had not been dissolved. 'This only means that the existing liability of any director or member prior to the dissolution of the company will continue in spite of the dissolution. If the directors are not personally liable for the plaintiff's claim prior to the dissolution of the company, they will not be liable after the dissolution'. And so in *Sri Krishna Dhoot v Kamalpurkar* [(1965) 1 Comp LJ 233: (1965) 35 Comp Cas 913AP]. The plaintiff, who had deposited certain notes with the Hyderabad Bullion Exchange Ltd, as membership security, instituted a suit against the company, its directors and members of its sub-committee for the recovery of the value of the notes when the company had become defunct and was dissolved by the Registrar by removing it from the register. Where the company had not been able to raise the requisite capital, its name was allowed to be stuck off.

The directors and other officers were, however, held not liable as there would have been no claim against them prior to the dissolution of the company. As for the liability of the company,

the court held that a suit against a company which is struck off the register and, therefore, stands dissolved, is not maintainable.

Directors are also not liable for their failure to maintain the routine of a company which to the knowledge of the Registrar is already defunct though actual striking off had been postponed for one reason or another. The court may order the winding up of the company without it being restored to the register. [*Calculating and Business Machines P Ltd v State of Bihar*, (1983) 54 Comp Cas 100 pat. See also *Narmada Choudhury v Motor Accidents Claims Tribunal*, (1985) 58 Comp Cas 596, directors held not personality liable.]

Restoration of Company

The proper procedure in such cases is to apply to the court for restoration of the company's name. For, Section 137(1) provides that if a company, or any member or creditor feels aggrieved, he may within five years from the date of publication of notice of cancellation of registration of the company move the court. It if is found that the company was actually carrying on business or it is other wise just to do so, the court may order the name of the company to be restored to the register. Accordingly, in *Bhogilal v Registrar of Joint Stock Companies*: [AIR 1954 MB 70]. The creditor of a defunct company filed a petition for restoration of its name. The petitioner alleged that he had obtained a decree against the company a day before the publication of the notification. The directors of the company on being asked by the Registrar misinformed him that the company was not in operation. It was also found that the entire share capital of the company was not called up and that the uncalled capital was sufficient to satisfy the decree. Holding that it was just and equitable to restore the name of the company to the register, the court observed: "No steps were taken to discharge the liability which the company owed to the petitioner. The effect of the order or removal would be to make it difficult for the petitioner to obtain the fruits of his decree. Had the Registrar known that the company was actually defending a suit, it is extremely unlikely that he would have ordered the name of the company to be removed from the register".

Thus, the provision relating to restoration 'seems primarily intended for companies which were active at the moment of their mortal wound'. But discovery of outstanding assets of the company is, of course, one of the reasons why restoration is sought. That is why a period of five years is allowed. The Company may have unknown assets which do not come to light until many years after the company has been struck off and so dissolved.

A contingent or prospective creditor is entitled to a petition for restoration. An income tax officer is a creditor for this purpose and can apply for restoration. So is a person entitled to claim damages under the Fatal Accidents Act. The company which has been struck off may itself apply for restoration, though the court would not order restoration unless there is sufficient evidence of likely benefit to creditors or shareholders.

An officer of the company who was instrumental in getting the company struck off was held to have *locus standi*. He was not aggrieved when he activated the process of striking off. He could become aggrieved subsequently. The Act requires the applicant to be aggrieved at the time of his application.

Restoration operates retrospectively. It produces 'as you were position'. An illustration of retrospective operation is *Box Co Ltd,* Re [(1970) 2 WLR 959: (1970) 2 All ER 183]. A company, in ignorance of the fact that it has been struck off the register, created a legal charge on two of its properties. On an application by the company the court restored it to the register and gave the order retrospective effect so as to validate the charges and their registration.

The effects of restoration have been thus stated in a case: It is clear from the section that on the restoration of a company back to the register after its being struck off the consequence is as though it had never been struck off the register.The company will be deemed to have had its existence although. Another consequence is that the rights of all parties would be as though there had been no cessation or interruption in the existence of the company on account of the striking off and the subsequent restoration.

Sub-section (5) also preserves the power of the Court to wind up a company the name of which has been struck off the register. This is so because striking off is different from winding up. In winding up the assets of the company are applied in payment of its debts. "But, if the name of a company is struck off the register, its un-disposed property is not appropriate towards its liabilities. It vests in the Crown as *bona vacantia"*. Thus, the liability of the directors of a wound up private company to pay outstanding income tax will not arise if the company is merely struck off. The department may apply for restoration.

COMPANIES NOT DISTRIBUTING PROFIT

In the past, the thinking in Nepal was that a company is intended for trading and engaging in gainful employment and how a company can be existing not for profit for the investors. Thus, the Government of Nepal never reconciled to the idea of a company being formed for non-profit activities till this Act of 2063 was enacted and was advising to register under the Association Registration Act, 2034 (Sanstha Darta Ain, 2034). But a company form of organization has been recognized in UK and India from the beginning of the 20th century for charitable and public service activities. Under Indian Act, the charitable company has to apply for a license not to use the word 'Limited' or 'Private Limited' along with its name and under Sec. 25 of the Indian Companies Act, the Government can authorize not to include the word 'Limited' or 'Private Limited' in its name.

Sec. 25 of the Indian Companies Act specifically states:

(a) Where an association is to be formed as a limited company for promoting commence, art, science, religion, charity or any other object; and
(b) to apply its profits or other income in promoting its objects and to prohibits the payment of any dividend to its member, the government, may be license, direct that the association be registered as a company with limited liability without the addition to its name of the word 'Limited' or the words 'Private Limited'.

Further a partnership firm can be a member of such company. Since if the company is for promotion of commerce, then many trading firms in the form of partnership can become members of the company.

Sec. 166(1) of Companies Act, 2063 enables such companies for developing and promoting any profession or occupation or to carry on any enterprise for the attainment of any scientific, academic, social, benevolent or public utility or welfare objective, on the condition of not distributing the profits to its members.

Now, any corporate body, i.e. an association registered under the Association Registration Act, 2034 as well as any trust can get itself registered under the Companies Act, 2063. But, while incorporating such company not distributing profit under the Companies Act, 2063, there shall have a minimum of five members as against 1 persons for private companies, 7 persons for a public company and 7 persons for a society. There is no maximum limit whereas in a private company the maximum member of members is one hundred one.

The membership of such company not distributing profit company is non-transferable. That is, ifthe life of a member comes to an end in any manner, then membership is automatically terminated.

(a) In the case of individual member: By death
(b) In the case of any corporate body: By dissolution or amalgamation with any other corporate body or company.

Except with the prior approval of the Office, a company not distributing profit shall not add the words such "company", " limited "' or "private limited" at the end of its name.

Sec. 167 makes certain special provisions regarding such companies:

(a) The company shall not require share capital to incorporate it. But, the company may receive membership fee from the member or any donation or aid for carrying out its purpose.
(b) Normally such companies cannot borrow money. Since it does not have a share capital and the Banks also will not give loan to such companies. But unless any member can undertake to bear the liability in writing, the member will not be liable for any liabilities of the company. If any member has accepted to make good the liability in writing up to a limit, then he will be liable only up to that limit and not more.
(c) All the provisions applicable to a listed company shall be applicable to the company, the directors, officers, auditors and employees except those applicable only to companies having share capital. It seems that similar to a listed company, following provisions shall apply:
    (i) Passing resolutions & voting;
    (ii) Laying annual financial statements and annual report at the annual general meeting and filing with OCR;
    (iii) Election and term of director;
    (iv) A person who is director of this company, if he receives any remuneration from this company, he cannot be a director of any other public company or not profit company drawing regular remuneration;
    (v) The company cannot borrow money or issue any debentures;
    (vi) Directors and their near relations will have to disclose their interest in any other entity with which this company enters into any transaction;

(vii) The directors will be subject to same disqualification applicable to directors of listed company;
(viii) Requirement of audit is applicable and the auditors cannot hold office for more than three years at a time.

(d) Any surplus earned during the year cannot be distributed to the shareholder as well as employees as dividend or bonus or in any other manner. Thus, Bonus Act is not applicable to a not for profit company. The surplus should be accumulated to increase its funds and for attaining its objects.
(e) If the company wants to add or remove any objects, then it should get prior approval of OCR. That is, before passing the special resolution for the change, it should get the approval. In the case of other companies, no such prior approval is required under the Act.
(f) Such company cannot be amalgamated with a profit making company.
(g) The member of company not distributing profit shall have one vote for one member. They may elect the number of directors as mentioned in the articles. Therefore Sec. 72 regarding the election of directors as well as proportional representation is not applicable here.
(h) In the case of company not distributing profit, the following expenses cannot be more than what is prescribed by OCR:
    (i) Meeting allowance, salary & perquisites receivable by the officers of the company;
    (ii) Pre-incorporation expenses;
    (iii) Operating expenses.

However, the administrative expenditure shall not exceed 25 % of the total expenditure.

(i) In case such company is dissolved or its registration is cancelled, any property remaining after repaying its liabilities, shall be disposed off as provided in the Articles of Association or otherwise shall be paid to the Government of Nepal. The Articles of Association cannot provide for distributing such remaining assets to its members but can provide to be given to any other charitable institution or company not distributing profit in which neither the promoters nor members nor his near relations are members or in other words, they are neither promoters nor members of such transferee institution.

If any of the above conditions are not followed, then the company registration can be cancelled by the Office of Company Registrar after giving opportunity to the company to explain. Against the decision of ROC, any person who disagrees with the decision to cancel the registration can appeal to the company court, i.e. the appellate court within 35 days from the date of coming to know the decision.

While canceling the registration, ROC can appoint a liquidator and auditor to wind up the affairs of the company within the time prescribed for completion of the winding up. They shall have the same powers & duties as prescribed in the Act for other companies.

It is not clear whether, if such not for profit company perform services to facilitate credit and insurance facilities, primary health services to the down trodden community will require the license from Nepal Rastra Bank or Insurance Board or Ministry of Health since they may not do such service for profit making.

Non-Profit Companies may be Established (Sec. 166)

(1) Notwithstanding anything contained elsewhere in this Act, a Company may be established to undertake any enterprise in order to develop or promote any occupation or profession, or protect the collective rights and interests of persons engaged in any particular occupation or profession, or achieve any educational, academic, social, philanthropic, or public utility or welfare oriented objective, subject to the condition that it may not distribute dividends.

(2) Any person or director of a public trust (guthi) registered under current law, or corporate body established under current law, desirous of establishing a Company to realize any of the objectives mentioned in Sub-Section (1) may submit an application to the Office as mentioned in Section 4.

(3) The number of promoters who wish to establish a Company under Sub-Section (1) must be at least five. The Company may have any number of members after its establishment.

(4) The membership of a Company established under Sub-Section (1) may not be transferred in any way. In case any member dies, or in case the registration of any member is cancelled, or in case any member is dissolved or merged into another institution or Company, the membership of the concerned person or institution shall terminate ipso facto.

(5) Unless the Office gives its approval in advance, a Company established under Sub- Section (1) need not write such terms as "Company", "Limited", and "Private Limited" along with its name.

(6) A Company registered under Sub-Section (1) must secure the approval of the Office before opening its branch offices.

19 COMPANY SECRETARY

Appointment of Company Secretary (Sec. 185)

(1) Every Company with a paid-up capital of Rs.10 million (Rs. One Crore) or more must appoint to the post of Company Secretary a Nepali national possessing the qualifications mentioned in Sub-Section (2).

(2) Any Nepali national who has acquired a professional certificate of Company Secretary from any national or foreign institution authorised under current law to issue such certificates and worked for at least two years in the concerned field, or acquired at least a Bachelor's Degree in law, management, commerce or economics and worked for at least three years in the concerned filed or in the field of Company management, may be appointed to the post of Company Secretary. However, this provision shall not be applicable to Company Secretaries holding office at the time of the commencement of this Act for three years from the date of the commencement of this Act.

(3) No Director of the concerned Company may be appointed as its Company Secretary.

(4) No person may be appointed as the Company Secretary of more than one Company at the same time. However, this provision shall not obstruct the appointment of the Company Secretary of a Holding Company as the Company Secretary of its subsidiary Company.

(5) In case this Act, prevailing law, or the Articles of Association provides that any function must be discharged by or through the Company Secretary, and in case the post of Company Secretary of a Company is vacant for any reason, or in case the Company Secretary holding office at the time does not or expresses his inability to discharge any such function, any employee of the Company who meets the qualifications prescribed in this Act and who is

designated by the Board of Directors of the Company to discharge such functions may work in the capacity of Company Secretary.

Functions, Duties and Powers of Company Secretary (Sec. 186)

(1) It shall be the duty of the Company Secretary to implement or make arrangements for implementing the decisions taken by the Board of Directors and the General Meeting and the directives issued by the Office or the concerned agencies, as well as to submit the statements, documents, decisions, etc. to be submitted by the Company to the Office or any other agency according to this Act or prevailing law within the prescribed time limit.

(2) The Company Secretary shall perform the following functions subject to this Act and the Memorandum and Articles of Association:
   (a) To convene meetings of the Board of Directors and General Meetings.
   (b) To prepare the agenda of meetings of the Board of Directors and General Meetings, and send them to the concerned Directors or shareholders.
   (c) To maintain records of the decisions of the Board of Directors and General Meetings, authenticate them, and take charge of them.
   (d) To send notices regarding share allotments and of calls for payment of installment, in accordance with the decision of the Board of Directors.
   (e) To keep the register of shareholders as well as the records of shareholders and debenture-holders in a correct and accurate manner, take charge of them, and authenticate them.
   (f) To record the pledge or mortgage of shares or debentures; to present matters relating to transfer or transmission of shares or debentures before the Board of Directors or the Executive Chief.
   (g) In case claims, complaints, grievances, suggestions, advice, etc. of shareholders or debenture-holders are submitted in writing, to forward them to the Board of Directors or the Executive Chief of the Office or other agencies, and inform the concerned shareholders or debenture- holders in writing about the outcome of the action taken in that connection.
   (h) To perform such other functions as are determined or prescribed under current law as those to be performed by the Company Secretary.

Code of Conduct of Company Secretary, 2065

Ministry of Industry has enforced a "code of conduct for company secretaries, 2065" on Kartik 11, 2065 through Nepal Gazette. The code of conduct requires the company secretary to do the following, thus the Company Secretary:-

   (a) Shall always direct his effort for good corporate governance
   (b) Shall abide by the employees regulation of the company in which he is working
   (c) Shall inform the company if he or his family has any interest in the transaction of the company.
   (d) Shall maintain transparency in the operation of Company except in cases where he is legally bound or from the business point of view of the company required to maintain confidentiality.
   (e) Shall assure the flow of information and notices according to the prevailing law within the time prescribed.

(f) Shall maintain the register of the documents authenticated by him as per the demand of shareholders or debenture holders.
(g) Shall inform the company if he is also holding office in any other company in any capacity or doing business or profession apart from working with the company. He must also follow the code of conduct of the business or profession in which he is involved.
(h) Shall follow the code of conduct of the Company prescribed for company secretary.
(i) Shall submit the report & notices to be sent to the appropriate authority in time.
(j) While preparing the declaration as per subsection (15) of section 78, he shall verify the truthfulness of such information and include all the information as prescribed by law.

Acts that are expressly directed as not to be performed by the code of conduct of Company secretary:

(a) He shall not perform any act to go against the principle of good corporate governance.
(b) He shall not misinterpret the laws so as to avail the corporate opportunity for his own benefit.
(c) He shall not obtain personal benefit from the company or through the company.
(d) He shall not use the information obtained in the capacity of company secretary for the benefit of himself or any other person.
(e) He shall not participate in activities which are in conflict with the interest or benefit of the company.
(f) He shall not misuse the asset of the Company.
(g) He shall not promote the withholding of information which is legally required to be made public.
(h) He shall not perform any act which hinders the image of the company or its employees.
(i) He shall not work as company secretary of any other company apart from the company or its subsidiary.
(j) He shall not disclose any information which directly or indirectly impacts on the price of the securities of the Company.
(k) He shall not keep negative feeling towards directors, auditors or other employees and act to unduly pressurize them.
(l) He shall not strive for or work on the basis of commission other than the salary, allowances received as per the rule of the company.
(m) He shall not be partner or director in an organization with profit motive which has the conflicting interest with that of the company in which he is working as a company secretary.
(n) He shall not disclose the information to unauthorized persons.
(o) He shall not join any other company as company secretary before giving a one month prior notice of joining another company.
(p) After retiring from office, he shall not disclose the information already not made public without the prior approval of the company unless he is legally bound to do so.

If any company secretary does not follow the code of conduct then, a complaint can be filed against the company secretary in the office of company registrar. The company registrar may direct the company to investigate and submit a report on the matter as prescribed.

If in the report submitted by the Company it is found that the company secretary has breached the code of conduct then the Company Registrar maydirect the company to take action against such Company Secretary as directed by the Company Registrar or relieve him of his duty as company secretary and it will be the duty of the concerned company to follow his order.

20 PUNISHMENT

Complaints and Actions on Cases under This Act (Sec. 159)

(1) Lawsuits may be filed and action taken under this Act only on complaints filed by the Office, director, officer, shareholder or member or creditor of the company, or any other concerned person, in respect to any matter under this Act.
(2) The power to hear and dispose of cases relating to offense punishable under this Act, cases which have been specified in the different Sections of this Act as those in relation to which complaints or petitions may be filed to the court, and other cases including those in respect to which the amounts of losses involved in the offense may be realised, shall vest in the court, except when clearly specified in this Act as those which are to be disposed of by the Office itself.
(3) The court shall hear and settlecases under this Act by adopting the procedure prescribed in the Summary Procedures Act, 2028 (1972).
(4) An appeal may be filed within 35 days to the court prescribed by Government of Nepal with the consent of the Supreme Court against the verdict given or order issued by the Office or the court under Sub-Section(2).
(5) Notwithstanding anything contained in Sub-Section (2), until Government of Nepal prescribes by notification in the Nepal Gazette, the court to hear cases and take other legal actions under this Act, the Company Board formed under Section 169 shall assume the jurisdiction of the concerned court under this Act.
(6) Except otherwise mentioned regarding time limitation for filing a case in any matter, no petition shall be accepted if not complained within two years from the date of knowing the reason to file the case in any subject.

Punishable with Fine not Exceeding Rs. 50,000 or with Imprisonment for a Term not Exceeding Two Years or with Both (Sec. 160)

Any of the following persons committing any of the acts mentioned below shall be punished with a fine ranging from Rs. 20,000/- to Rs.50,000/-, or with imprisonment for a term not exceeding two years, or with both:

(a) To any Director or Officer of the company, in case the causes any loss or harm to the company or any person by inserting false particulars in any document of the Company with mala fide motives or through malicious negligence.
(b) To any Director or Officer of the company, in case he fails to keep or cause to be kept books of accounts or accounts, records or registers or fails to maintain accuratelyor does not maintain updated accounts and records as required under this Act, or suppresses, conceals or damages such accounts, records or registers.

(c) To the auditor of the company, in case he inserts false particulars in his report while discharging his duty, or omits necessary comments while auditing the accounts, either with mala fide motives or through malicious negligence.
(d) To the liquidator, in case he does not convene a meeting of creditors, or settles debts or liabilities contrary to the order of priority, or fails to keep accounts, records or registers as required under this Act, or does not take over accounts and documents which he is required to take over, or maintains false accounts, or fails to submit reports which he is required to submit, or does not hand over cash, stores or accounts to be handed over by him on the termination of his assignment, either with mala fide motives or through malicious negligence.
(e) To any director, officerand employee, in case he does not hand over according to this Act documents, records, cash and stores in his charge on the termination of his office or on receipt of an order to liquidate the Company to the person appointed to receive them, and to the latter in case he fails to receive them.
(f) To any director orofficer, in case he inserts false particulars in the prospectus or issues the prospectus of the company before its registration with the Office.
(g) To the director orofficer, in case he takes or orders any action beyond the authority of the Board of Directors or the jurisdiction of the company.
(h) To any shareholder, in case he does not submit the particulars to be submitted by him under this Act or submits false particulars.
(i) To any director, officeror employee, in case he misappropriates or commits irregularity in respect to the cash or stores of the Company, or uses the cash or stores of the Company for personal purposes without the approval of the Board of Directors or the General Meeting, or fails to clear advance payments according to the rules of the Company, or does not comply with the orders issued by the Office and does not submit the particulars of the Company.
(j) To any Director or officer responsible for submitting or furnishing statements or information to the Company, the Office, the court, or any other body under this Act, in case he fails to submit or furnish such particulars or information.
(k) To the auditor, in case he audits the accounts of a Company even after learning that he is disqualified for auditing the accounts of the Company.
(l) To any director orofficer, in case he exercises any power not vested in him or acts beyond the authority vested in him.
(m) A director and officer who maintains account in contravention of this Act;
(n) Tothe director and officer, in case he does not make available extracts of Financial Statements, Annual Financial Statements or reports to be made available to the shareholders pursuant to this Act.
(o) To the company, its directors and substantial shareholders, providing or obtaining any loan facility or remuneration from the company in a manner opposed to the provisions of this Act.
(p) To the company, directors, officers, employees or any other persons suppressing or giving false names of creditors or submitting false particulars about the loans obtained by the company while seeking the permission of the court to reduce the share capital of the company.

(q) To any private company, its directors and shareholders, in case it / he sells shares or debentures in a manner opposed to this Act.
(r) To any foreign company operating its business or enterprise in Nepal in a manner opposed to this Act, to its director, employee or representative.
(s) To any debenture-trustee or any of its directors or officer acting in a manner opposed to the interest of the debenture-holders.
(t) To person, in case he has acted in contravention of sub-section (7) of section 46.
(u) To any Director or officer, in case he fails to do what he is required to do under Section 60.
(v) To any person, in case he conducts a business by using the term "Company" without registering a company under this Act.
(w) To any company, director or officer not furnishing information or notice under Section 141 or Section 175.
(x) To the shareholder of a company, in case he does not furnish information demanded under Section 47, or to the company, director or officer, in case it / he does not submit to the Office any information received from the shareholders under that Section.
(y) To thedirector andofficer, in case he acts in contravention of Section 105.
(z) To the managing director, director or officer of thecompany, in case he does not give to the Office the address of the registered office of the company even after repeated orders issued in writing, or, if that was not possible, even after being sent notices -through any means of communication.
(aa) To thecompany, director, substantial shareholder andofficer, in case the company, director, substantial shareholder or officer takes any action in contravention of Section 50.
(bb) Company or officer who acts contrary to the objective of the company intentionally,
(cc) Inspector deputed under section 121 if submits the false report.

Punishable with Fine not Exceeding Rs. 50,000 (Sec. 161)

A person who commits any of the following offenses shall be punished with a fine ranging from Rs. 10,000 to Rs. 50,000.

(a) To the Officer or person, in case he allots shares in contravention of the provisions of this Act.
(b) To every Director of a company, in case the company purchases its own shares or the shares of its holding company, or makes any investment, from out of its reserve capital in contravention of this Act.
(c) To the officer or person who is required to produce, hand over or furnish accounts and records when sought by the auditor, in case he fails to do so.
(d) To the auditor, in case he fails to submit the report specified in this Act.
(e) To the Directors, Managers and Office-bearers of a Company which fails to make arrangements as mentioned in Sub-Section (3) of Section 172.
(f) To the Director and Officer, in case he takes any action in contravention of Section 146 or 147, or fails to keep the records, books or returns to be maintained under this Act.
(g) To the Company, Director, Auditor, Officerand employee, in case it / he takes any action in contravention of the provisions contained in Chapter 18 or fails to fulfill the duties and obligations specified in that Chapter.
(h) To the Director, Officer or person, in case he does not convene a General Meeting or a meeting of the Board of Directors which he is required to convene under this Act, or

does not send the notice of a General Meeting or a meeting of the Board of Directors which he is required to send, or does not prepare documents which he is required to prepare so as to be made available to shareholders before holding a General Meeting, or does not submit documents which he is required to submit at the meeting.

(i) To the officer who sets down any false deed or content of document stating that any matter which was neither done or happened to have been done or happened and *vice versa* in the minutes as referred to in Sub-section(1) of Section 75 and Sub-section (7) of Section 97 or such other return or report as required to be prepared an submitted to the company or Officer in such notice or information as required to be provided pursuant to this Act;

(j) In the event that an declaration made by the directors pursuant to Sub-section(2) of Section 136 is held to be false, the director who makes such false statement;

(k) To the person who does false or wrong translation of any deed or document required to be submitted by a foreign company to the Office pursuant to this Act or any person who certifies the same.

Punishable with Fine not Exceeding Rs. 20,000

Except in matters provided for in Sections 160 and 161, the court shall impose a fine ranging from Rs.5,000 to Rs.20,000 on any company or its concerned officer or employee in case it / he fails to perform any function or fulfill any duty which it / he is required to perform or fulfill under this Act, or performs any function prohibited by this Act, or performs without adopting the prescribed procedure or after the expiry of the prescribed time-limit any function which it/he is required to perform within the prescribed time-limit or in accordance with the prescribed procedure, or does not furnish any information or submit any statement which it / he is required to furnish or submit to the Office.

Payment of Compensation for Losses

In case a director, officerof any company or any person causes any loss to the company or shareholder orcreditor or any other person by committing any offense which is punishable under this Act or by violating any provision of this Act or the Memorandum of Association, Article of Association or unanimous agreement, the aggrieved company, shareholder, creditor or any other person may realize compensation therefore from him. The concerned director, officer or person shall be required to bear the amount involved in the loss from his personal property.

21 MISCELLANEOUS

Formation of Company Advisory Board (Sec. 168)

(1) Government of Nepal shall form a Company Advisory Board consisting of not more than nine members to be chosen from among persons who have acquired at least bachelor degree in law, accountancy, tax administration, commerce or business administration and gained expertise by working in the concerned field for at least seven years, at the rate of one member from each field, from both the private and public sector, and a representative of the Federation of Nepalese Chambers of Commerce and Industry, by notification in the Nepal Gazette, in order to study the practical problems faced in the enforcement of this Act

and current law relating to Company administration, and to offer advice to Government of Nepal on effecting timely reforms in current law and on the issue of reforms to be made in Company administration, according to need. The Registrar shall be the Member Secretary of the Company Advisory Board.

(2) While forming the Advisory Board under Sub-Section (1), the concerned notice shall also designate one of the members as the Chairperson of the Advisory Board.

(3) Annual Reports of the functions performed by the Company Advisory Board under Sub-Section (1) must be submitted to the concerned Ministry of the Government of Nepal.

(4) The concerned Ministry shall make public the report submitted under Sub-Section (3) and also make arrangements for enabling the public to obtain it at a reasonable price.

Provisions Concerning the Secretariat and Employees of the Company Advisory Board

The Secretariat of the Company Advisory Board to be formed under Section 168 shall be located in the Office of Company Registrar. .

Now the government has notified the High Court as the designated court, with effect from 1stMagh 2065. The provision relating to Company Board has become *functus officio*, or non-functional body as per Section 169(1).

Company's Records and Computer Application

Sec. 172 provides for keeping the following records of a company required under the Act to be maintained either manually in registers or by electronic or computer medium in readable form or in codified form or by any other method, without prejudice to the provisions contained in this section:

(a) Minutes book,
(b) Shareholder or Debenture holder register,
(c) Index of shareholders or debenture holders,
(d) Books of Account and accounts etc

If any of the above records are kept, without maintaining in manual registers, in any other manner, then the following matters should be followed:

(a) If these records are kept in a place of easy access with a view to facilitate reading or taking copies of the same, then they will be considered to have been kept in any specific place.
(b) The company should make sufficient arrangement that the records are not destroyed or altered by any one and that the matters recorded therein can be easily traced and copies thereof could be obtained.
(c) Where the matter is recorded in a manner that is not readily legible or it is in a coded form, then the matter shall be capable of being reproduced in a legible form.
(d) The date of preparation and date of any alteration made also should be clearly recorded.
(e) If the records are kept in a non-legible form and if, according to law, an obligation is imposed on the company either those records are to be allowed for inspection or copies are to be submitted, then it will be the obligation of the company to make such arrangements that the relevant portion of the records can be inspected and that copies there of can be provided in a visible or legible form.

Conversion of Government Body into Company under This Act

Sec. 173 provides for the conversion of a government body constituted under any other prevailing law as a public company under this Act. The government may convert into a public company a body fully or partly owned by it and incorporated as:

(a) a public corporation under prevailing laws (i.e. Corporation Act or special Acts),or
(b) a development board under the Development Board Act, 2013

In this case there is no restriction (i.e. minimum 7) on the number of promoter shareholders required for incorporation of a public company under the Act. There can be only one promoter or shareholder i.e. any ministry of the government represented by the secretary of the concerned ministry.

The assets and liabilities of the erstwhile corporation or board can be revalued and treated as the share capital of the new company. If so transferred, unless provided otherwise in the Articles of Association, all the liabilities and assets shall devolve on the new company.

Not withstanding anything contained in other provisions of the Act, the number of directors of the new company shall be as provided in the Articles of Association and such director need not hold any share qualification.

The new company can sell its shares through the stock exchange or by negotiation to the private sector in bulk by adopting provisions of Privatization Act, 2053. But for doing so, it will have to get its shares registered under the Securities Act, 2063

Handing Over Charge to the Successor

Sec. 174 provides that any director or any other officer or employee of a company shall at the expiry of his term of office shall hand over the documents and record**s** in his charge to the successor director or officer or other employee of the company, who takes charge of the office for performing the function previously carried out by the person leaving, within thirty days of such expiry. But the section is silent as to what happens if no person is appointed to succeed. But non observance of this section may attract penalty under sec.162 and 163.

Power to Give Directive (Sec. 178)

In case the Office receives in any way any information to the effect that any company, its director, officer or any other employee has not done something that he is required to do under this Act or the Articles or Memorandum of Association, or the unanimous agreement in the case of a private company, or that any such person has taken or is about to take any action in contravention of this Act or the Articles of Association of the company, the Office shall inquire into the matter, or make arrangement for doing so, and issue necessary directives to the concerned person to do or arrange for doing what he has to do or refrain from doing something which he should not do. It shall be the duty of the concerned person who receives any such directives to comply with it.

Actions in Contravention of this Act or Articles of Association to beVoid

Unless otherwise provided for in this Act or the Memorandum or Articles of Association, in case any action has been taken in a Company or in connection with a Company by refraining from doing something that should have been done or doing something that should not have been done under this Act and the Memorandum or Articles of Association, such action shall be void.

But sec.104 makes any act entered into by a third party in good faith with the company shall be valid and the officer who has done it will be personally responsible to the company unless the company in general meeting exonerates him by ratifying the act.

Transactions between Associated Companies (Sec. 175)

This section does not prohibit the transactions between associated companies but only want transparency to be observed by informing the shareholders and the OCR.

The transactions covered under this section are those directly or indirectly resulting in:

(a) Any financial assistance in the form of loan or in any other manner,
(b) Payment of any liability of the other,
(c) Any agreement or provision giving guarantee or other security,
(d) Any other (extraordinary) transaction other than regular trade transactions.

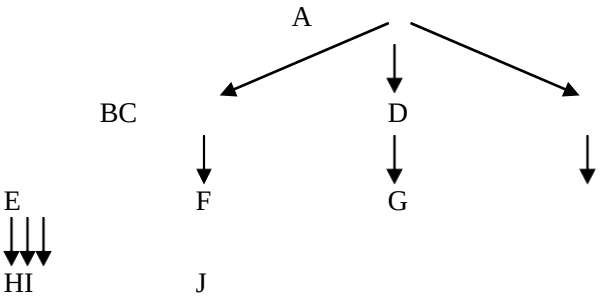
The information should be given as early as possible (please note that no time limit is prescribed) and should contain the following information:

(a) The date of the transaction and parties involved in the transaction,
(b) The nature of the transactions and if the transaction involves any loan, financial assistance and giving guarantee, then the amount or price involved.

But if annual general meeting is nearby, the information can be given in the directors report circulated with the annual financial statements. The sections consider the following companies as associate companies:

(a) Any company and its holding company,
(b) Any company and other subsidiary of its holding company,
(c) Subsidiary of any company and holding company of such company,
(d) Subsidiary of any company and other subsidiary of its holding company.

Here the relationship intended to be covered can be explained thus:



Clause (a) covers transactions between A and [B, C or D].
Clause (b) covers transactions between B and [C or D]
Clause (c) covers transaction between E & A, F & A, and G & A.
Clause (d) covers transaction between E & I, E & J, E & C, E & D, E & F and E & G. Similarly for others.

Restriction on Transactions between Companies (Sec. 176)

The restrictions relate to the following three transactions resulting directly or indirectly:

(a) To lend money to any other company
(b) To give guarantee against loans taken by any other company
(c) To invest in the securities of any other company

It may be noted that the word used under clause (a) above is '*Sãpati*' which normally means advance given with or without any interest on the same, to be returned after the purpose of use is over. The full amount may not be returned. But only after spending for the purpose for which advances given, balance will be returned...

The section provides a maximum limit up to which there will be no restriction as follows; i.e. the transaction value should not exceed the following limits, whichever is higher:

(a) 60% of the paid up share capital + free reserves or
(b) 100% of the free reserves.

Only transactions exceeding the limit is prohibited.

But the section provides various exceptions to which this restriction will not apply as follows:

(a) Companies operating banking or financial transactions,
(b) Insurance companies,
(c) Company having the prime object of purchasing and selling securities or investing in securities,
(d) Private company which has not taken any loan from any bank or financial institutions,
(e) Company having the prime object of providing physical infrastructure facilities,
(f) Investment made by a holding company in its fully owned subsidiary company,
(g) Money lent by a holding company to its fully owned subsidiary company,
(h) Any guarantee given by such holding company against loans taken by such subsidiary,
(i) Investing in any rights shares issued under the Act,

It is also provided that the company giving such loans or guarantee or making investment shall maintain the details, as prescribed, on the moneys lent by it to another company, investment made by it in such company or guarantee given by it for a loan borrowed by such another company and then submit it to OCR along with inventory Sec. 51(2).

Registered Office of the Company (Sec. 184)

Every company shall inform the OCR and register the address of its registered office with OCR within three months of its incorporation. The company shall give to OCR the contact address, like telephone, fax, e-mail etc.

Every company shall place a signboard outside its registered office containing its name and address in Nepali language in a conspicuous manner to be seen by all.

Investors Protection Fund (Sec. 183)

Where any investor does not present a claim to have refunded the amount that has flown to be invested even within five years, the said amount shall be deposited in the Investor Protection fund to be established. Under section 182, unpaid dividend outstanding for more than five years remaining with any company unclaimed by the shareholders also will be deposited in the Investors Protection fund. How capital invested will not be claimed have to be examined and it is possible in the following cases only:

(a) Where shares were applied for but no allotment is made and is to be refunded
(b) Where shares were forfeited and after sale by the company of the forfeited shares, the amount is to be paid to the member.
(c) Where there is a reduction of share capital and some amount out of the paid up capital has to be refunded to the members.

The section has not clarified the circumstances under which such invested amount shall become refundable to the investor and not claimed by the investor. How the Investor protection fund will come to know of it and how it can claim the amount is not detailed in the Act.

The fund may also receive moneys from the Government of Nepal, or any donor agency or form any person or body.

The amount of the fund may be utilized for the following purposes:

(a) Improvement to the capital market, investment policy, company law, or professional laws relating to trade and business;
(b) Giving training to the employees of OCR or companies:
(c) In any other activity relating to company administration.

The management and operation of the Fund shall be done by a committee consisting of the Registrar of Office of Companies Registrar, chairperson of the Securities Board or his representative and one person appointed by the Securities Board from among the organizations operating the stock exchange.

OCRshallkeep the accounts of the expenses made out of the fundand get them audited. It is provided before crediting the amount to the Fund, a notice shall be published by the concerned

company inviting the concerned investor to receive the amount grantingat least one month from the date of publication of notice in a national level daily newspaper. The Investor protection Fund shall be managed and operated as per Investor Protection Fund Management and Operation Procedure, 2073.

Case Related to Companies Act, 2063

1. Bhuminanda Sharma Dawadi Vs HMG. 2062/5/6, Some Landmark Precedents of the Supreme Court on Commercial Law, (1959-2005) Supreme Court of Nepal, 2006
2. Khem Chandra Chaurasia VS HMG, Department of Industries, NKP 2045, Page 507
3. Piyush Bahadur Singh et.al. Vs Tax Office Kathmandu, NKP 2040, Page 901
4. Prakash Shrestha Vs HMG, Nepal, NKP 2061, Page 687
5. Prakash Bahadur Singh et.al, NKP, 2045, Page 655
6. Surya Narayan Das Vs Dairy Development Corporation, Kathmandu, NKP 2045, Page 419
7. Sushil Rani Vs Hotel Jaya International, NKP 2041, Page 259
8. Tarani Prasad Adhikari Vs G.M. Surya Bahadur, NKP 2065, Page 1093
9. Tej Raj Panta Vs Board of Directors, Timber Corporation et.al, NKP 2044, Page 895
10. Piyush Raj Pandey Vs Tax Office Kathmandu, NKP 2040, Vol-12, Page 901
11. Bijay Kumar Dugadh Vs Industrial Promotion Board, NKP 2061

CHAPTER- 3

SECURITIES ACT, 2063

1 INTRODUCTION

Here the objective is to make the students clear as to the functioning of securities market watchdog, the brief explanation is given on the securities exchange commission of USA, FSA of UK.

Security Exhange Commission

Development of capital markets in a regulated manner required a regulator and the first such regulator was the US Security Exchange Commission.

The U.S. Securities and Exchange Commission (commonly known as the SEC) is an independent agency of the United States government which holds primary responsibility for enforcing the federal securities laws and regulating the securities industry, the nation's stock and options exchanges, and other electronic securities markets. The SEC was created by section 4 of the Securities Exchange Act of 1934 (commonly referred to as the 1934 Act). In addition to the 1934 Act that created it, the SEC enforces the Securities Act of 1933, the Trust Indenture Act of1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Sarbanes-Oxley Act of 2002 and other statutes.

The SEC was established by the United States Congress in 1934 as an independent, non-partisan, quasi-judicial regulatory agency during the Great Depression that followed the Crash of 1929. The main reason for the creation of the SEC was to regulate the stock market and prevent corporate abuses relating to the offering and sale of securities and corporate reporting. The SEC was given the power to license and regulate stock exchanges, the companies whose securities traded on them, and the brokers and dealers who conducted the trading.

Currently, the SEC is responsible for administering seven major laws that govern the securities industry. They are: the Securities Act of 1933, the Securities Exchange Act of 1934, the TrustIndenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of1940, the Sarbanes-Oxley Act of 2002 and most recently, the Credit Rating Agency Reform Act of 2006.

The enforcement authority given by Congress allows the SEC to bring civil enforcement actions against individuals or companies found to have committed accounting fraud, provided false information, or engaged in insider trading or other violations of the securities law. The SEC also works with criminal law enforcement agencies to prosecute individuals and companies alike for offenses which include a criminal violation.

To achieve its mandate, the SEC enforces the statutory requirement that public companies submit quarterly and annual reports, as well as other periodic reports. In addition to annual financialreports, company executives must provide a narrative account, called the "management discussion and analysis" (MD&A) that outlines the previous year of operations and explains how the company fared in that time period. Management will usually also touch on the upcoming year, outlining future goals and approaches to new projects. In an attempt to level the playing field for all investors, the SEC maintains an online database called EDGAR (the Electronic Data

Gathering, Analysis, and Retrieval system) online from which investors can access this and other information filed with the agency.

Quarterly and annual reports from public companies are crucial for investors to make sound decisions when investing in the capital markets. Unlike banking, investment in the capital markets is not guaranteed by the federal government. The potential for big gains needs to be weighed against equally likely losses. Mandatory disclosure of financial and other information about the issuer and the security itself gives private individuals as well as large institutions the same basic facts about the public companies they invest in, thereby increasing public scrutiny while reducing insider trading and fraud.

The SEC makes reports available to the public via the EDGAR system. SEC also offers publications on investment-related topics for public education. The same online system also takes tips and complaints from investors to help the SEC track down violators of the securities laws.

History

Prior to the enactment of the federal securities laws and the creation of the SEC, there existed so-called Blue Sky Laws, which were enacted and enforced at the state level. However, these laws were generally found lacking; the Investment Bankers Association told its members as early as 1915 that they could "ignore" Blue Sky Laws by making securities offerings across state lines through the mail. After holding hearings on abuses on interstate frauds (commonly known as the Pecora Commission), Congress passed the Securities Act of 1933 (15 U.S.C. § 77a) which regulates interstate sales of securities (original issues) at the federal level. The subsequent Securities Exchange Act of 1934 (15 U.S.C. § 78d) regulates sales of securities in the secondarymarket. Section 4 of the 1934 Act created the U.S. Securities and Exchange Commission to enforce the federal securities laws. Both laws are considered part of Franklin Roosevelt's "New Deal" raft of legislation.

The Securities Act of 1933 is also known as the "Truth in Securities Act" or the "Federal Securities Act‖ and is often shorted to the "1933 Act." Its goal is to increase public trust in the capital markets by requiring uniform disclosure of information about public securities offerings. The primary drafters of 1933 Act were Huston Thompson, a former Federal Trade Commission chairman, and Walter Miller and Ollie Butler, two attorneys in the Commerce Department's Foreign Service Division, with input from Supreme Court Justice Louis Brandeis. For the first year of the law's enactment, the enforcement of the statute rested with the Federal Trade Commission, but this power was transferred to the SEC following its creation in 1934. The law requires that issuing companies register distributions of securities with the SEC prior to interstate sales of these securities, so that investors may have access to basic financial information about issuing companies and risks involved in investing in the securities in question. Since 1996, most registration statements (and associated materials) filed with the SEC can be accessed via the SEC‘s online system, EDGAR.

The Securities Exchange Act of 1934 is also known as "the Exchange Act" or "the 34 Act". This act regulates secondary trading between individuals and companies which are often unrelated to the original issuers of securities. Entities under the SEC‘s authority include securities exchanges

with physical trading floors such as the New York Stock Exchange (NYSE), self-regulatory organizations such as the National Association of Securities Dealers (NASD), the MunicipalSecurities Rulemaking Board (MSRB), online trading platforms such as NASDAQ and ATS, and any other persons (e.g., securities brokers) engaged in transactions for the accounts of others.

President Franklin Delano Roosevelt appointed Joseph P. Kennedy, Sr., father of President John Kennedy, to serve as the first Chairman of the SEC, along with James M. Landis (one of the architects of the 1934 Act and other New Deal legislation) and Ferdinand Pecora (Chief Counsel to the United States Senate Committee on Banking and Currency during its investigation of Wall Street banking and stock brokerage practices). Other prominent SEC commissioners and chairmen include William O. Douglas (who went on to be a U.S. Supreme Court justice), Jerome Frank (one of the leaders of the legal realism movement) and William J. Casey (who would later head the Central Intelligence Agency under President Ronald Reagan).

As part of the continuing investigation in 1974-75, Watergate scandal prosecutors offered companies that had given illegal campaign contributions to Richard Nixon's re-election campaign lenient sentences if they came forward. Many companies complied, including Northrup-Grumman, 3M,American Airlines and Braniff Airlines. By 1976, prosecutors had convicted 18 American corporations of contributing illegally to Nixon's campaign. The SEC, in a state of flux after its chairman was forced to resign his post, began to audit all the political activities of publicly traded companies. The SEC's subsequent investigation found that many American companies were making vast political contributions abroad.

Structure

The SEC consists of five Commissioners appointed by the President of the United States with the advice and consent of the United States Senate. Their terms last five years and are staggered so that one Commissioner's term ends on June 5 of each year. To ensure that the SEC remains non-partisan, no more than three Commissioners may belong to the same political party. The President also designates one of the Commissioners as Chairman, the SEC's top executive. However, the President does not possess the power to fire the appointed commissioners, a provision that was made to ensure the independence of the SEC. This issue arose during the 2008 Presidential Election in connection with the ensuing Financial Crises.

Within the SEC, there are four divisions, 18 offices and approximately 3,800 staff. Headquartered in Washington, DC, the SEC has 11 regional offices throughout the United States.

The SEC's four main divisions are: Corporation Finance, Trading and Markets, Investment Management, and Enforcement.

Corporation Finance is the division that oversees the disclosure made by public companies as well as the registration of transactions, such as mergers, made by companies. The division is also responsible for operating EDGAR.

The Trading and Markets division oversees self-regulatory organizations (SROs) such as FINRA (Financial Industry Regulatory Authority) and MSRB(Municipal Securities Rulemaking Board), and all broker-dealer firms and investment houses. This division also interprets proposed changes to regulations and monitors operations of the industry. In practice, the SEC delegates most of its enforcement and rulemaking authority to FINRA. In fact, all trading firms not regulated by other SROs must register as a member of FINRA. Individuals trading securities must pass exams administered by FINRA to become registered representatives.

The Investment Management Division oversees investment companies including mutual funds and investment advisers. This division administers federal securities laws, in particular the Investment Company Act of 1940 and Investment Advisers Act of 1940. This Division's responsibilities include:

- Assisting the Commission in interpreting laws and regulations for the public and SEC inspection and enforcement staff;
- Responding to no-action requests and requests for exemptive relief;
- Reviewing investment company and investment adviser filings;
- Assisting the Commission in enforcement matters involving investment companies and advisers;and
- Advising the Commission on adapting SEC rules to new circumstances.

The Enforcement Division works with the other three divisions, and other Commission offices, to investigate violations of the securities laws and regulations and to bring actions against alleged violators. The SEC generally conducts investigations in private. The SEC's staff may seek voluntary production of documents and testimony, or may seek a formal order of investigation from the SEC, which allows the staff to compel the production of documents and witness testimony. The SEC can bring a civil action in a U.S. District Court or an administrative proceeding which is heard by an independent administrative law judge (ALJ). The SEC does not have criminal authority, but may refer matters to state and federal prosecutors.

The SEC also works with federal and state law enforcement agencies to carry out actions against actors alleged to be in violation of the securities laws.

Financial Service Authority of UK

The Financial Services Authority (FSA) is an independent non-governmental body, given statutory powers by the Financial Services and Markets Act 2000. This is a company limited by guarantee and financed by the financial services industry. The Treasury appoints the FSA Board, which currently consists of a Chairman, a Chief Executive Officer, three Managing Directors, and 9 non-executive directors (including a lead non-executive member, the Deputy Chairman).

This Board sets our overall policy, but day-to-day decisions and management of the staff are the responsibility of the Executive.

The FSA is accountable to Treasury Minister, and through them to Parliament. It is operationally independent of Government and is funded entirely by the firms it regulates. The FSA is an open and transparent organisationand provides full information for firms, consumers and others about its

objectives, plans, policies and rules, including through its website. An area of this website provides information specifically for consumers on financial products, regulation and their rights.

FSA is an independent body that regulates the financial services industry in the UK. FSA has been given a wide range of rule-making, investigatory and enforcement powers in order to meet the four statutory objectives. In meeting these, FSA is also obliged to have regard to the Principles of Good Regulation.

FSA's Statutory Objectives and Principles of Good Regulation are summarized in three Strategic Aims:

- Promoting efficient, orderly and fair markets,
- Helping retail consumers achieve a fair deal, and
- Improving our business capability and effectiveness.

The Financial Services and Markets Act gives FAS four statutory objectives:

- Market confidence: maintaining confidence in the financial system,
- Public awareness: promoting public understanding of the financial system,
- Consumer protection: securing the appropriate degree of protection for consumers, and
- The reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purpose connected with financial crime.

These are supported by a set of principles of good regulation which will have to be observed when discharging the functions. The objectives also:

- Provide political and public accountability. FAS's annual report contains an assessment of the extent to which FAS have met these objectives. Scrutiny of the FSA by Parliamentary Committees may focus on how FAS achieve its objectives,
- Govern the way FAS carries out their general functions e.g. rule-making, giving advice and guidance, and determining our general policy and principles. So, for example, FAS is under a duty to show how the draft rules they publish relate t otheir statutory objectives, and
- Assist in providing legal accountability. Where FSA interprets the objectives wrongly, or fail to consider them, FSA can be challenged in the courts by judicial review.

The FSA's aim is to promote efficient, orderly and fair financial markets and help retail financial service consumers get a fair deal.

The FSA was set up by government. The government is responsible for the overall scope of the FSA‘s regulatory activities and for its powers.

The FSA regulates most financial services markets, exchanges and firms. It sets the standards that they must meet and can take action against firms if they fail to meet the required standards.

One of FSA's statutory objectives is to reduce the extent to which it is possible for a financial business to be used for a purpose connected with financial crime.

Financial crime includes any offence involving money laundering, fraud or dishonesty, or market abuse. The objective interacts with three other objectives: protecting consumers, market confidence, and public awareness.

But the recent North Rock Bank's failure has put a question mark on FSA's ability to track bad banking practices in time.

The Securities Board of Nepal was constituted with the objective to make timely the laws relating to securities by amending and consolidating such laws in order to regulate and manage the activities of the securities markets and persons involved in the business of dealing in securities by regulating the issuance, purchase, sale and exchange of securities for the purpose of protecting the interests of investors in securities, by developing the capital market to mobilize necessary capital for the economic development of the country.

2 SECURITIES BOARD OF NEPAL

Establishment of Board [Sec. 3 of the Act]

Securities Board of Nepal is established for managing the activities of the person involved in securities market and securities practice for managing the issue, buying, selling, distribution and exchange of securities in continuous way by developing the capital market by protecting the interests of the investor investing insecurities.

Following members will be included in the Board so established

(a) Person nominated by Government of Nepal -Chairperson
(b) Joint Secretary, Ministry of Finance -Member
(c) Joint Secretary, Ministry of Law, Justice and Parliamentary Affairs -Member
(d) Representative, Nepal Rastra Bank -Member
(e) Representative, The Institute of Chartered Accountant of Nepal -Member
(f) Representative, Federation of Nepalese Chambers of Commerce and Industries -Member
(g) Person nominated by Government of Nepal having minimum Post Graduation in Economics, Management, Finance, Commerce or Law from recognized university having minimum experience of seven years in securities market, management, development of capital market, finance and economy sector -Member

Nomination of representative by concerned institution should be done as per (e) & (f) above having minimum graduation in Account, Industry, Commerce, Finance, Banking, Economy or Law and having minimum experience of seven years.

Tenure of service of the representative nominated as per clause (g) above, will be of three years. There will be no effect on the activities done by the Board due to the vacancy of any member.

Work of secretary will be done by the officer employee of the Board as prescribed by the Board. If it is felt necessary, the Board can invite any indigenous or foreigner expert, advisor as an observer in the meeting of Board. Central office of the Board will be in Kathmandu and Board can establish branch and liaison office within Nepal or outside if found necessary.

Right, Duties and Function of Board [Sec. 5 of the Act]

The main function is protection of the interest of investing public and regulation of the capital markets and market participants. For the purpose the Board has the following duties and powers:

(a) To offer advice, as per necessity, to the Government of Nepal on matters incidental to the development of capital market,
(b) To register the securities of any corporate body established with the authority to make a public issue of its securities,
(c) To regulate and systematize the issue, transfer, sale and exchange of registered securities,
(d) To grant permission to any corporate body, which is desirous of operating a stock exchange, to operate the stock exchange subject to this Act or the rules and bye-laws framed under this Act,
(e) To regulate and monitor the activities of the stock exchange;
(f) To inspect as to whether or not any stock exchange is executing its activities in accordance with this Act or the rules and bye-laws framed under this Act, and to suspend or revoke the license of such a stock exchange, if it is found that the same has not been done,
(g) To issue a license to companies or institutions, which are desirous of carrying on the securities business subject to this Act or the rules and bye-laws framed under this Act,
(h) To regulate and monitor the activities of securities business person,
(i) To classify securities business persons and fix their standards according to their functions and capability by fulfilling such procedures as prescribed,
(j) To grant a permission to operate collective investment schemes and investment fund programs, and to regulate and monitor the same,
(k) To approve bye-laws of stock exchanges and those bodies which are related with securities business and engaged in securities transactions, and to issue orders to stock exchanges and those bodies which are related with securities business and engaged in securities transactions to make necessary amendment in their bye- laws with a view to making necessary provisions concerning the development of capital market and protecting the interests of investors in securities,
(l) To systematize the clearance of accounts related to securities transactions,
(m) To supervise whether or not security business persons have maintained such conduct as prescribed in this Act or the rules, bye-laws and directives framed under this Act, while carrying on securities business, and suspend or revoke the license to carry on securities business where any securities business person is not found to have maintained such a conduct,
(n) To make or cause to be made, such arrangements as may be necessary to regulate the volume of securities and the mode of securities transactions for the promotion, development and healthy operation of stock exchanges,
(o) To make such arrangements as may be necessary to prevent insider trading or any other offense relating to securities transactions for the protection of the interests of investors in securities,
(p) To review, or cause to be reviewed, financial statements submitted by corporate bodies issuing securities and securities business persons, and give such directives to the concerned corporate bodies as it deems necessary in this connection,
(q) To regulate and make transparent the act of acquiring the ownership of a company thereby gaining control over its management by purchasing its shares in a single lot or in several lots,
(r) To maintain coordination and exchange cooperation with the concerned agencies in order to supervise and regulate matters concerning securities or company affairs,

(s) To perform or cause to be performed such other functions as may be necessary in relation to securities and the development of capital market

Decisions and Meetings of Board [Sec.6 of the Act]

- Chairperson will call the meeting of Board as may be found necessary. Such meeting will be held at least once in a month.
- Meeting will be held at the place, time and date as fixed by the chairperson.
- The Board meetings will be presided over by the chairperson and in the absence of chairperson, the meeting will be presided over by the member selected from amongst themselves.
- Chairperson has to call the meeting of Board if written request is made by two members to call the meeting and such meeting should be held within seven days after the receipt of such notice.
- Secretary of the Board should provide the list of subjects to be discussed at the meeting along with the notice calling the meeting to the members.
- Quorum for the meeting shall be more than fifty percent of total number of members present at the meeting.
- Majority decision will be applicable in the meeting of Board and in the case of equal votes chairperson of the meeting is entitled to give decisive casting vote
- Name of the members present in the meeting, subject of discussion and decision made in meeting should be kept in separate minute book along with the signature of the members present at the meeting.
- Decision made by the Board should be presented to all the members by the secretary after authentication by him.
- Other activities related to the meeting of the Board will be as decided by the Board itself

Appointment of Chairperson [Sec. 7]

For conducting the daily activities as chief administrative of the Board, a chairperson shall be appointed by Government of Nepal. Such chairperson shall be appointed from among the renowned persons having minimum post-graduation qualification with minimum seven years of experience in the field of management of securities market, development of capital market, economics, finance, commerce, management or law. For recommendation of the name, there shall be one committee of experts under the coordination of the member from the NationalPlanning Commission looking after concerned area with Secretary at the Ministry of Finance and an expert of the securities field as its members. While recommending the names of persons fulfilling the qualifications as per the Act as per sub-section (3), names of at least three persons shall be recommended.

Tenure of the chairperson shall be of four years and he can be re-appointed for another maximum of four years. If the chairperson does anything against the interest of the Board by causing loss to the Board or against the development of capital market, Government of Nepalmay form an inquiry committee for investigation and chairperson can be removed from the post on the recommendation given by the committee. But an opportunity is to be given to the chairperson for presenting any explanation from his side.

Formation of Inquiry Committee

If a situation of dismissal of chairperson or member due to he or she doing anything against the interest of the Board by causing loss to the Board or against the development of capital market, an inquiry committee may be formed by the Government of Nepal for carrying out necessary investigation within certain time limit as per sub-section (7) of section 7 of the Act and Rule 11 of. Securities Board of Nepal Regulation, 2064 Inquiry committee shall consist of following members:

(a) Person nominated by the Government of Nepal among the judge in- office or retired judge of high court - Chairperson
(b) Serving Gazetted First class officer in judicial service of the Government of Nepal - Member
(c) Expert nominated by the Government of Nepal having expert knowledge related to capital markets - Member

Inquiry committee so appointed may make necessary inquiry, take statement or require explanation from the chairperson or concernedmember. Procedure followed while doing investigation will be determined by investigation committee itself. On the basis of report furnished by inquiry committee, Government of Nepal may take necessary action or dismiss such chairperson or member.

Rights, Duties and Function of Chairperson [Sec. 8 of the Act]

The main duties of the Chairman shall be:

(i) To carry out the necessary actions for the development of the Capital market and to protect the interests of the investors insecurities,
(ii) To regulate and supervise or cause to be supervised the activities of the stock exchange and the securities traders for making the transactions in securities strong, effective and dependable,
(iii) To work as the chief executive of the Board,
(iv) To present the long term and short term plans and policy for the management of securities market and development of capital market for approval to the Board,
(v) To Call or cause to be called the meetings of the Board or presiding over the meeting,
(vi) To prepare the annual program and budget of the Board and presenting to the Board for its approval,
(vii) To implement or cause to be implemented the decisions of the Board,
(viii) To carry out the activities of the Board as per the objectives of the Board by inspection and supervision of the daily activities of the Board,
(ix) To appoint advisors and employee as prescribed,
(x) To carry out other works delegated by the Board,
(xi) Other duties and work and powers will be as prescribed in the rules which are as follows:
(xii) To take complete administrative responsibility of the Board for carrying out the daily activities and management of the Board subject to the Act, rules, byelaws, sub-regulations or directives and guidelines or the decision taken by the Board from time to time,
(xiii) To follow up, supervise and investigate or cause to be followed up, supervised or investigated the corporate body whose shares are registered, the stock exchange and the securities traders,

(xiv) To represent the Board before the Government of Nepal, courts or national or foreign associations,
(xv) To sign any contracts on behalf of the Board and to implement or cause to implement the same,
(xvi) To do other works as may be delegated by the Board.

Qualification of Chairperson and Members [Sec. 10]

For the appointment of chairperson and members following qualifications have to be fulfilled by the person:
(a) Citizen of Nepal,
(b) Having high moral character,
(c) Minimum seven years of professional experience in the field of management of securities market, development of capital market, economics, finance, commerce, management or law,
(d) Not disqualified as per section (11).

Disqualification of Chairperson and Member

Section 11 provides, following persons shall not be qualified for appointment in the post of chairperson and member:
(a) Officer of a political party,
(b) Person involved in securities business,
(c) Insolvent Person being unable to pay his debts,
(d) Person of unsound mind,
(e) Person punished by a court in a criminal proceeding relating to moral turpitude.

Dismissal of Chairperson and Member [Sec. 12]

In the following cases, the chairperson and member shall be dismissed from their post by the Government of Nepal. Government of Nepal shall not debar the concerned person from presenting clarification before dismissing him.
(a) Disqualified to be a chairperson and member as per section(11),
(b) Doing activities against the interest of securities investors and activities affecting the development of capital market,
(c) Lack of working skill to implement and execute the works for accomplishment of the goal of the Board as per the Act and the rules made there under,
(d) Due to undesirable conduct, certificate for carrying out any business or profession has been cancelled or ban for conducting any business is imposed,
(e) Not attending continuously more than three meetings of the Board without any notice.

Chairperson and member may resign from their post by giving written resignation letter to the Government of Nepal [Sec. 13].

Filling up of Vacant Post [Sec. 14]

If the post of the chairperson and member becomes vacant before the completion of the period, Government of Nepal shall appoint any person on the vacant post for the remaining period of time by fulfilling the procedure as per the Act.

Provision Related to Account Expert, Advisor and Employee [Sec. 19]. The Board shall have such numbers of accounts experts, advisors and employees as may be necessary for the efficient operation of the functions of the Board.

Appointment, remuneration, facility and condition of service of the Account expert, advisor and employee shall be as prescribed.

Taking Oath [Sec. 20]

Chairperson, member, advisor of Board and the employee appointed for first time in the Board have to take oath as prescribed for confidentiality and honesty, before starting the work as per their designations. Chairperson and member shall take oath of faithfulness as per format of schedule -1 before starting activities of the office in their respective capacity.

Secrecy [Sec. 21]

Chairperson, member, advisor of the Board, employee, auditor, agent or the representative cannot do the mention below:

(a) To pass away or disclose the secret information and message received while fulfilling the duty by reason of being in the post.
(b) To use such information and message for personal benefit.

Notwithstanding anything mentioned above, secret information and message can be disclosed if obtained by fulfilling the procedure as prescribed by the Board under the following circumstances:

(a) Disclosing the information and message while fulfilling his duty in public, in the process of helping the body implementing law or order given by court or by an order of an officer having authority.
(b) Giving information and message to the auditor of the Board while fulfilling his duty.
(c) Disclosing the information and message for the benefit of the Board in a legal case.

Fund of the Board [Sec. 22]

Board is an autonomous corporate body. Hence, as an individual it receives and generates fund from different sources subject to Securities Act, 2063.

There will be a separate fund of the Board consisting of the following amounts:

(a) Grant and other amount received from Government of Nepal,
(b) Grant, assistance and loan received from national, foreign or international institutions, organizations or bodies. But prior -approval of Government of Nepal shall be taken before taking such grant, assistance or loan,
(c) Amounts received from the License fee,
(d) Amount received from the registration fee of securities,

(e) The amount of fees, and charges received in respect of doing or causing to do the transactions of securities,
(f) Amount received from the fine charged by the Board,
(g) Amount received from any other source.

All amounts received by the Board as above will be deposited in any commercial bank situated in Nepal. All expenses incurred by the Board will be borne from the money deposited in the fund created as above. All expenses incurred will be incurred on the basis of budget for the income and expenditure of the fiscal year approved by the Board. Operation of the fund of the Board will be as prescribed.

Provision of Non-Expendable Fund (Revolving Fund) [Sec. 23]

Board may establish revolving fund for providing it an income and an amount prescribed by the Board shall be deposited in the fund every year. Amount remaining in non-expendable fund can be kept in term deposit account as prescribed by the Board or can be invested in the securities issued by Government of Nepal. Generally no amount can be spent from the non-expendable fund except the income generated from the fund. The provision for operating the non-expendable fund will be as prescribed.

Accounts, Auditing & Annual Report of the Board [Sec. 24 & 25]

Board has to keep up to date Record of the activities of theBoard. Board has to prepare the income and expenditure statement, balance sheet and account statement related to accounts as per international accounting standard, within six months of the end of the fiscal year.

Auditing of ledger and books of account of the Board will be done by Auditor General or by the auditor prescribed by him. The auditor has to include the following in his audit report besides the report on auditing of ledger and books of account:
(a) Whether true income and expenditure of the fiscal year is shown or not by the income statement.
(b) Whether true financial position of the Board for the fiscal year is disclosed or not by the balance sheet.

Chairperson has to present to the Board the annual report of the activities of Board within four months after the end of the fiscal year, and one copy of such report should be submitted to the Government of Nepal. The annual report of the Board prepared as above shall be published for the information of the general public each year.

3 ISSUE & REGISTRATION OF SECURITIES

As per section 2(f) of the Act, "Securities" means any shares, stocks, bonds, debentures, debenture stocks or collective investment scheme certificate issued by a body corporate or treasury bonds, saving bonds or bonds issued by the Government of Nepal or by a body corporate against the guarantee of the Government of Nepal, and this term also includes such other securities as may be specified by the Board to be transacted or transferable through the stock exchange or the instrument to purchase, sell or exchange such securities. "Securities

transactions" means the issue, purchase, sale or exchange of securities and other acts pertaining there to.

ISSUE & REGISTRATION OF SECURITIES

Registration of Securities [Sec. 27]

A body corporate has to register the securities with the Board before issuing it. For registration of securities to be issued by a body corporate, it shall submit an application in the prescribed format with its memorandum of association and articles of association and the documents related to the securities along with the prescribed fee.

When application for registration of security has been received, the Board has to do necessary investigation and if found suitable, it may register the security and enter the necessary details in the prescribed register and then provide the certificate of registration of securities to the concerned body corporate in the prescribed format. Notwithstanding anything mentioned in this section, the body corporate which has issued securities before the enactment of this Act has to register its securities with the Board within one year from the commencement of this Act.

Sale and Allotment of Securities [Sec. 28 of the Act]

If there has been a sale or allotment of the securities of the body corporate after getting it registered, then the notice along with the details of such sale or allotment of the securities, such information along with statement of sale and allotment should be given to the Board within seven days.

After receiving such information, if it is felt necessary the Board can give necessary direction to the concerned body corporate for allotment and sale of the securities in a fair and informative way for the benefit of investors and body corporate. It is the duty of the concerned body corporate to follow the direction.

Issue of Securities Publicly [Sec. 29]

If abody corporate is to issue securities to more than fifty persons at a time then sale and allotment of such securities should be made through a public issue of the securities. The time for the application for securities to be issued to be kept open will be as prescribed. Now, this has been prescribed as four days the date of opening of the issue for subscription. If the issued securities are not fully sold, the body corporate may provide time of 15 days for the application of securities from the date of opening of the issue for subscription and information thereof shall be provided to the Board. The price and procedure of allotment of the securities issued publicly will be asprescribed.

The Board had issued a regulation for registering and issuing the securities, 2057. But that was replaced by the Securities Public Issue regulations, 2065 after the new Securities Act, 2063 came into force. It has again been replaced by Securities Registration and Issue Regulations, 2073. It lays down certain conditions for public issue of security by a body corporate

While making a public issue, at least 50% of the issue should be underwritten by the underwriters approved by the Board and the agreement of underwriting should include the conditions that will be prescribed by the Board.

Issue of Shares by Circular

A public company, if it desires to issue its shares by private circular, it should apply for permission form the Board for such issue. While making application for permission to issue share by circular, the following information should also be provided:

(a) Resolution of the general meeting for the issue of shares by circular;
(b) Memorandum of association and articles of association of the body corporate;
(c) Capital structure of the body corporate;
(d) Audited financial statements of previous fiscal year;
(e) Number of shares proposed to be issued;
(f) The list of intended participants to whom the circular is to be issued;
(g) Procedure for allotment of the shares;
(h) Provision regarding listing and transactions of the shares

If the Board is satisfied with the application and information provided, it can give permission for the issue of shares by circular.

Issue of Right Shares

If anybody corporate desires to issue right shares, then the face value of the shares already issued should have been fully paid up.

In one financial year, only one issue of rights shares will be permitted. While issuing rights shares, the previous issue of shares and rights shares should have been listed in the stock exchange and there should be an interval of at least 180 days interval between the previous issue and the present issue.

If the body corporate is issuing the rights shares to comply with the direction of the regulating authority regulating the business of the company, then indicating the said fact, a resolution of the general meeting authorising the issue of right shares should have been passed.

The directors and substantial shareholders of the company should take up the right shares and make payment for the same and only after that they can make issue open to the general public shareholder group for subscription. If any director or substantial shareholder does not take the right shares, then with that information the issue of the general public can be opened. If the director or substantial shareholder intends to renounce his right shares in favor of some other person, then at least 3 days prior to opening of the issue, the rights should have been transferred and the money in respect of the same should be deposited with the issuance bank.

If the right shares are issued by a company on its own without any compulsion from any regulatory authority, then the company should pass a resolution from the general meeting for issuing such shares giving information relating to the object of increasing the capital, the amount

intended to be raised, the purpose for which the money is to be utilized, the proportion in which the shares are to be offered.

When a company applies to the Board for issue of right share the following information should be disclosed:

- If the right shares are issued by a company is by compulsion from any regulatory authority, then the information regarding this.
- Information regarding the reason why the right share had to be issued, the plan to invest the capital raised, and the return from such investment.
- The proper basis to show that the ratio declared for the issue of right share and the financial condition to support such basis.

Publication of Prospectus [Sec. 30]

After the commencement of this Act, body corporate has to publish the prospectus for the public issue of the securities, after getting the prospectus approved by the Board. While publishing the prospectus, the place to see or receive the prospectus by the public, shall also be mentioned in theprospectus. However, there is no need to publish the prospectus to issue the securities as mentioned below.

(a) Securities issued by Nepal Rastra Bank,
(b) Securities issued on the full guarantee of Government of Nepal,
(c) Securities proposed to issue for a maximum of fifty person at a time,
(d) Securities issued to its employee or worker,
(e) Securities for which the Board has approved for issue without publishing the prospectus.

Approval of Prospectus [Sec. 31]

The Board shall approve only the prospectus which includes information related to the assets and liabilities, financial condition, profit and loss and matters sufficient for evaluation of future expected activities of the issuer by the investor. If the Board wants to carry out site inspection before authorizing the prospectus then it can do so and it can issue any precondition to be fulfilled before the issue is to be made and this should be complied before the issue.

Matters to be mentioned in Prospectus [Sec. 32]

General things to be mentioned in a prospectus, capital and other information of the issuer, main activities carried on by the issuer, information related to any legal actions, financial condition of the issuer, general administration, management and information related to the experts preparing the prospectus and the financial statements included in prospectus will be as prescribed. The details as per the Issue Approval guidelines is given at the end of this chapter.

Accountability of the Matters Contained In Prospectus [Sec. 33]

Accountability for the truth of the information related to the documents mentioned in the prospectus which is presented to the Board for the approval after getting registered for the issue of the securities shall be the concerned corporate body, the directors signing the prospectus and the experts preparing such prospectus severally or jointly.

Any loss or damages occurring to the people after buying the securities believing the things written in prospectus which turned out to be false then such loss should be borne by the concerned corporate body, director or the expert preparing the prospectus. But the director proving that he was not aware of the falsification of the prospectus or that he resigned before deciding in bad faith or knowingly to the things written in prospectus will not be liable to compensate the loss incurred.

Suffered investor may complain to the concerned district court within thirty five days after knowing such falsehood within one year from the date of investment to claim compensation for the loss occurred to him due to the false presentation of prospectus, information, message or statement submitted to the Board.

Information to be provided by Body Corporate [Sec. 34]

The Body Corporate issuing the securities should provide the following information to the Board and the shareholder as soon as possible:

(a) The necessary and supporting information to evaluate the financial conditions.
(b) Information affecting the transaction of stock exchange and price of the securities.

A Body Corporate issuing the securities should provide other prescribed information and notices to the Board and shareholder in addition to the matters stated above.

Compensation for Cancellation of Listed shares [Sec. 35]

Where the body corporate issuing securities has listed its securities by making agreement with stock exchange and where the listing of the securities of the said body corporate was canceled for the reason of not following the provisions in this Act or the rules and byelaws made under this Act, the directors of the body corporate shall be personally or jointly liable to compensate any loss or damages caused to the shareholder due to the cancellation of the listing done by the securities market.

SECURITIES ISSUANCE AND ALLOTMENT GUIDELINES, 2074

Securities Board has issued Securities Issuance and Allotment Guidelines, 2074. The major features are as follows:

Issue of Debenture

A company while issuing debenture should mention following details in the prospectus:

(a) The objective of issuing debenture and the way the amount received by issue of debenture is to be utilized, the time limit of debenture, rate of interest, time period in which the interest is to be paid, the duration of debenture.
(b) Whether the debenture holder will have the primary or secondary right on the prior right holders or their group, the name of the group and the amount.
(c) In general proportion of the debenture and the capital should not be more than 70:30 if the proportion is more, then the ratio and the appropriate basis for such greater proportion should be mentioned in the prospectus.
(d) In case of convertible debenture the conversion ratio, price, premium, conversion date and the right to vote.

(e) If the debenture is issued against the security of assets then such asset should be valued by expert.
(f) If Redeemable Debenture is to be issued then there should be the provision of Debenture Redemption Reserve Fund for the redemption of debenture.
(g) There should be a clause in the Deed between the debenture trustee and company according to the law in force in such a way that it is beneficial to the investors.
(h) If the company is to issue the debenture convertible into shares the provision of the companies act should be followed.
(i) In case of company when it has to issue a debenture having secondary right on the asset of the company the amount of debenture raised should not be more than fifty percent of the company's net worth.

Net worth here means the paid up share capital, reserve fund (except reserve from revaluation of assets) after deducting accumulated loss and Deferred expenditure and miscellaneous expenses not written off.

Further Public Issue

The company wanting to issue share publicly should make a clear provision in the memorandum for further public issue. The corporate body shall be required to meet the following criteria for further public issue:
(a) Operating in profit for last 3 years in the period of 5 years.
(b) Three years have been completed from the date of public issue of the body corporate.
(c) Adopted resolution in the general meeting for further public issue.
(d) If issue is to be made for the price exceeding the face value, the bases for determining the issue price.
(e) Published prospectus for the purpose of further public issue.

Issue of Securities at Premium

If the shares are to be issued at premium the application must be made to the Board along with following documents and details:
(a) The body corporate is operating in net profit for continuous period of 3 years.
(b) The networth per share of the body corporate exceeds paid up value per share.
(c) The general meeting of the body corporate has adopted resolution to issue share at premium.
(d) The method and basis of the share price of the share to be issued at premium.
(e) The body corporate has abided the provisions relating to premium determination as provided in the directive.
(f) The body corporate has scored the average credit rating or exceeding the average credit rating.

If the Board is satisfied then the Board will give permission to issue shares at premium.

Time in Which the Issue is to be a Made

The company should issue securities within two months from the date in which the prospectus and sale proposal has been approved by the Board. If there is long public holiday and many securities are being issued at a single time then that should be taken into consideration. If the

issue cannot be materialized within the period of two months then if there has been any change in technical, financial aspect or management of the company then the new prospectus incorporating such changes must be got approved from the Board before issuing the securities.

The issue manager can prescribe the bank, financial institution or merchant bank as the collection center for distributing and collecting the application form. Such distribution and collection center must enter into an agreement with the issue manager as to the conditions and fees for the service rendered. Such centers must make a commitment to follow the law in force and the rules there under. The collection centre prescribed by the issue manager for issue should be intimated to the Board seven days before the date of issue.

The Issue Manager Should Enter Into an Agreement with the Banker to the Issue

The issue manager should enter into an agreement with the banker to the issue for depositing the amount collected from the applicant to the issue stating the following:

(a) The account number in which the amount is to be deposited in the issue Bank.
(b) The interest to be paid on such account
(c) The procedure and time to pay the company issuing the securities.
(d) The details for depositing and collecting money from the collection centers.

Not more than 50 % of the Issue Price of shares as advance can be called along with the share application as per the company law prevailing at the time. More than 50% of the Issue price of shares can be asked along with the share application in case it is provided through special Acts or for the company in operation it has published the balance sheet for the previous three years.

Provision for Promotion and Advertisement

The company should advertise and promote the share to be issued through issue manger in the public media for the knowledge of general public. Apart from informative promotion and advertisement there should not be anything to lure the investors to invest in those shares. The issuing company or the issue manager must not advertise as to the demand of securities being excessive, during the period when issue is open, except when it is substantiated by the fact.

Minimum Details to be disclosed in the Share Application

The minimum details to be mentioned in the share application:

(a) Full name of the applicant both in Nepali and English.
(b) The name of father and grandfather of the applicant.
(c) If the applicant is married then name of the spouse.
(d) The permanent address, contact address and telephone number of the applicant.
(e) The address, name of the bank or financial institution in which the applicant has bank account and his account number.
(f) The number of shares applied for and the amount deposited for the purpose.
(g) The signature of the applicant and in case of a minor signature of the guardian.
(h) If there is the provision for the identification of the applicant his identification number.
(i) The information on reason as to how an application form could be cancelled.
(j) Brief information of the company issuing such security.

(k) The Name and address of the collection centre where application form has been submitted along with date of submission.

The applicant should affix his recent photograph on the form, when ever applicant is a company or other organized institutions then the copy of registration certificate of the company, the decision of the Board of directors to apply for the securities along with the photo of the director of the company or executive officer of the company or chief officer of such institutions. A maximum of two rupees can be collected against the application form by indicating on the form itself.

Collection of Application Form

The issue manager must make following provisions while collecting the application form:

(a) The form should be duly filled and signed by the applicant before submitting the form and it should be submitted along with the copy of citizenship certificate;

(b) In case of minor, if father / mother has to become guardian, the copy of birth certificate received from the registrar of birth and death, duly attested by the guardian along with the copy of citizenship certificate of the guardian should be submitted. If any person other than the father / mother wants to become his guardian, of the minor or a person of unsound mind, then the proof of legal guardianship must be submitted.

(c) One person can submit only one form if two or more than two forms is found to be submitted then all the forms submitted by him will be cancelled.

Processing of Application & Collection of Custody of Application Money

All the applications not duly filled or which do not contain the prescribed documents should be segregated and not included in the allotment. Such application form should be sent back to the collection centers. When one person is found filling two applications then all the application forms filled by him are to be cancelled.

In case of public issue, the issue manager should give details to the Board of the application forms and money received each day in each collection center within the office hours of the following day. The money thus collected by the issue manager should be deposited each day and the money received by each collection center should deposit the money on same day or the following day in the bank account of the banker to the Issue.

Allotment of Security and Refund of Money

The issue manager should submit to the Board the securities allotment table as per securities allotment directives issued by the Board three working days prior to the allotment. Once a security has been mentioned as a security to be issued to general public in the prospectus the same cannot be reserved for special class or group during allotment but this will not effect the allotment to be made to the employees or the joint investment fund or the local people mentioned in the prospectus itself.

Time for Completion of Allotment

The completion time is given with respect to the application received for the purchase of Securities:

(a) From 1 to 2,00,000: 30 days
(b) 2,00,000 to 3,00,000: 40 days
(c) Above 3,00,000: 50 days

If the allotment cannot be made in the time period given above, the amount received as application money should be refunded and interest should be given to the applicant from the date of closing to the date of refund along with the interest at the rate of Government Saving Certificate. In case of right shares and debentures, the allotment & refund should be made within thirty days of the closing of issue.

Refund of Money

The Issue Manager should start distributing the allotment advice and the money to be refunded within 5 days of allotment, if not then interest should be given from the date of closing of issue to the date of refund along with the interest at the rate of Last rate of interest of government Saving Certificate. The refunded amount should be refunded in such a way that the money is deposited in the bank account of the applicant mentioned in the application.

Shares Apportion for Employees

Company can apportion maximum of 5% of the total share to be issued to public to be allotted to employees. But taking into consideration the number of employees the percentage to be issued to employees is to be calculated as follows:

(a) From 1 to 50: 2 %
(b) From 51 to 100: 3%
(c) From 101 to 200: 4%
(d) From 201 and above: 5%

If shares have been already issued to employees before issuing to general public by making special provision in the memorandum or article of association, then the employees cannot be allotted from the shares to be issued to general public.

4 STOCK EXCHANGE

The First Stock Exchanges

In 11thcentury France the courtiers de change were concerned with managing and regulating the debts of agricultural communities on behalf of the banks. As these men also traded in debts, they could be called the first brokers.

Some stories suggest that the origins of the term "bourse" come from the Latin bursa meaning a bag because, in 13thcentury Bruges, the sign of a purse (or perhaps three purses), hung on the front of the house where merchants met.

However, it is more likely that in the late 13th century commodity traders in Bruges gathered inside the house of a man called Van der Burse, and in 1309 they institutionalized this until now informal meeting and became the "Bruges Bourse". The idea spread quickly around Flanders and neighboring counties and "Bourses" soon opened in Ghent and Amsterdam.

In the middle of the 13thcentury, Venetian bankers began to trade in government securities. In 1351, the Venetian Government outlawed spreading rumors intended to lower the price of government funds. There were people in Pisa, Verona, Genoa and Florence who also began trading in government securities during the 14th century. This was only possible because these were independent city states ruled by a council of influential citizens, not by a duke.

The Dutch later started joint stock companies, which let shareholders invest in business ventures and get a share of their profits or losses. In 1602, the Dutch East India Company issued the first shares on the Amsterdam Stock Exchange. It was the first company to issue stocks and bonds. In 1688, the trading of stocks began on a stock exchange in London.

On May 17, 1792, twenty-four supply brokers signed the Buttonwood Agreement outside 68 Wall Street in New York underneath a buttonwood tree. On March 8, 1817, properties got renamed to New York Stock & Exchange Board. In the 19th century, exchanges (generally famous as futures exchanges) got substantiated to trade futures contracts and then choices contracts. There are now a large number of stock exchanges in the world in every country.

Stock exchange has been defined as a market, place or facility for performing the purchase, sale or exchange of securities on regular basis by taking together the purchasers and sellers of securities.

Setting up a Stock Exchange

Whoever wants to set up and operate stock exchange, should obtain license from the Securities Board. Without obtaining such license no one can operate a stock exchange allow purchase, sellor exchange securities or use the name ‘Stock Exchange’.

Only a Body Corporatemay apply for a license to run a stock exchange. The Body Corporate is to be registered under the Companies Act as a public company. Such company may be registered by OCR only on the recommendation of the Securities Board of Nepal [Sec. 36]. Such Body Corporate shall file an application in the prescribed format with prescribed details and documents along with the application fees [Sec. 37]

The Securities Board may issue the license of stock exchange, if it is satisfied on the following matters [Sec. 38]:

(1) Granting license will be for the benefit of the investors and general public or if it is felt that it is necessary to give license to such exchange for proper operation of the Capital market.
(2) If the applicant fulfills the following condition:
    (i) The Body Corporate has been established with the main object of establishing and operating a stock exchange;

(ii) It will ensure a paid up capital of at least Rs.5 Crores by the time it is able to start operation;
(iii) Arrangements to the satisfaction of the Board are made for necessary management, the infrastructure and ability to provide the facility for operating the stock exchange;
(iv) Arrangement for listing or otherwise for recognizing the securities traded through the stock exchange;
(v) Proposed by law for operating the stock exchange, arrangements for carrying out transaction and the process to be adopted, like open floor invoice bidding or computerized bidding etc. to ensure that the transactions will be carried out in a proper manner to the benefit of the investors;
(vi) Arrangements made for proper settlement of transaction on the stock exchange and for keeping records and particulars of the transactions;
(vii) Arrangement for investigating the complaints lodged with regard to transaction carried out by the members;
(viii) Matters relating to disciplinary actions according to bye- laws against members who do not comply with the liability under the contracts entered into by them.

Apart from these, the Board may prescribe additional conditions also and the Board may modify such condition from time to time taking into account the condition of the capital market, healthy operation of securities market and the interest of the investors [Sec. 39].

The Board may refuse to give license if it finds that there is no necessity for a stock exchange considering the development of industries and business and the feasibility of the existing stock exchange transactions and it is not in the interest of investor to allow a stock exchange to operate [Sec. 40].

Stock Exchange shall have a minimum paid-up capital of Rs.5 Crores or such amount as may be notified by the Board from time to time and also have sufficient financial resources [Sec. 41].

The license issued is valid for one year up to the end of the financial year in which the license was issued and it shall be renewed every year not later than three months from the close of the each financial year. If it is not renewed within the first three months, then it may be renewed on payment of additional 25% of the annual fee as penalty, within next three months from the expiry of the first three months i.e. the license can be renewed before the end of Ashwin or renewed with payment of penalty within Poush of the year. If it is not so renewed, then the license shall be cancelled [Sec. 42].

The stock exchange is permitted to deal only in the securities of Companies listed by it in accordance with it bye-laws, transaction of non-listed securities will be as notified by the Board [Sec. 43].

The Board of directors of the Stock Exchange shall bear responsibility for the management of the securities transaction of the stock exchange [Sec. 44].

Functions, Duties and Powers of the Stock Exchange [Sec. 45]

(a) To conduct the securities transaction done by the exchange in a transparent, healthy and regulated manner,
(b) To keep in mind the interest of the common general investors,
(c) To make the member to follow the Act, rules made under the Act and the bye- laws and in that connection to follow up and supervise the same,
(d) To maintain an adequate transaction flow with all facilities,
(e) To arrange for qualified and capable employees for managing the exchange,
(f) To have proper procedure and adequate facilities for contingency and security arrangements and management,
(g) To make bye-laws with the permission of the Board for listing of the shares whose transactions are to be carried out and membership management,
(h) To do other things necessary for conducting the affairs of the stock exchange.

Information to be provided

Stock Exchange shall inform the Board immediately on coming to know of the following matters:

(a) Where any financial irregularities are committed by any members and as a result the financial condition of the member has become suspicious;
(b) If any member does not fulfill his legal obligation or become incapable of fulfilling the same;
(c) If any member does not follow the financial rules, or if it is seen that he is not in a position to do so;
(d) Any other information as may be prescribed.

The Stock exchange may give necessary direction to any company whose shares are transacted in the exchange if it is found that such company is contravening the terms of the agreement with Stock Exchange or to make the share transaction more healthy and regulated or keeping the interest of the investors and if the stock exchange deems it necessary to give such direction. It is the duty of the concerned company to comply with the direction.

A stock exchange shall render necessary assistance to the Board for the performance of functions referred to in this Act. In the course of rendering such assistance, if the Board asks for any information or advice on securities transactions or on any other specific matter, such information or advice shall also to be provided to the Board.

Stock Exchange to Submit a Report [Sec.47]

Stock exchange shall submit to the Board a report on the activities carried out by it in each fiscal year not later than three months after the expiration of such a fiscal year.

Ceiling on Stock Transaction [Sec. 49]

The Board may fix ceiling on the volume of shares in a single trade or ceiling on the securities that a person can hold at a time by making purchase / sale of securities in the manner prescribed. While fixing such ceiling, it can be fixed separately on the basis of the type of individual security

or type of transaction. Apart from the above, the Board may also notify and decide the maximum number of stock of any type that a person can hold in his ownership.

Stock Exchange to Pay Fee to the Board [Sec. 50]

Stock Exchange shall pay a transaction fee to the Board on all the purchase, sale and exchange of securities in the exchange and collecting the same from the transacting parties. Such transaction fee shall not exceed 0.03 per cent of the transaction value. Such fee collected in one month should be paid before the close of the next month. For any delay in payment, interest at 10% is to be paid. It will also be treated as having committed an offence under the Act if not so paid in time.

Action against Members [Sec. 52]

If the stock exchange has asked for explanation from any members to take any action against its members or has suspended or cancelled the membership of such member or having levied penalty on any member, or any other action, such matters should be reported to the Board within 7 days giving the name of the members, details of action taken and the reasons for taking such action.

Compensation Fund [Sec. 53]

The stock exchange will have to organize and manage a compensation fund to compensate the investors from possible loss. The amounts credited to the fund shall be used to provide compensation as prescribed. In case the stock exchange is not able to establish the compensation fund or unable to manage the same or failed to give the prescribed compensation, or not in a position to give, then the Board may make necessary arrangement to establish, and manage the investor compensation fund or to give the compensation amount as prescribed.

Regulation for Managing Compensation Fund [Sec. 54]

Regulations shall contain the arrangement for depositing the amount into the fund, maximum amount of compensation under the fund, maintenance of accounts and Audit of the fund, condition for claiming compensation and the procedure, conditions under which no claim can be made, manner of proceedings and decision for paying compensation claim. In addition, it shall contain the limit of the maximum amount of compensation that could be given to one person, other matters regarding investigation in connection with the claim, arrangement in case of cancellation of license of the stock exchange and any other matter in relation to compensation.

Nepal Stock Exchange

Nepal Stock Exchange, in short NEPSE, is established under the Companies Act, 2006 operating under Securities Exchange Act, 2007.

The basic objective of NEPSE is to impart free marketability liquidity to the government and corporate securities by facilitating transactions in its trading floor through member, market intermediaries, such as broker, market makers etc. NEPSE opened its trading floor on 13th January 1994.

Government of Nepal, Nepal Rastra Bank, Rastriya Banijya Bank Limited and members are the shareholders of NEPSE.

History

The history of securities market began with the floatation of shares by Biratnagar Jute Mills Ltd. and Nepal Bank Ltd. in 1937. Introduction of the Company Act in 1964, the first issuance of Government Bond in 1964 and the establishment of Securities Exchange Center Ltd. in 1976 were other significant development relating to capital markets.

Securities Exchange Center was established with an objective of facilitating and promoting the growth of capital markets. Before conversion into stock exchange it was the only capital markets institution undertaking the job of brokering, underwriting, managing public issue, market making for government bonds and other financial services. Government of Nepal, under a program initiated to reform capital markets converted Securities Exchange Center into Nepal Stock Exchange in 1993.

Members

Members of NEPSE are permitted to act as intermediaries in buying and selling of government bonds and listed corporate securities. At present, there are 50 member brokers, who operate on the trading floor as per the Securities Act, 2007, rules and bye-laws. The broker house and its branches are expanded over 21 different cities of Nepal.

Trading

NEPSE the only Stock Exchange in Nepal introduced fully automated screen based trading since 24th August, 2007.

The NEPSE trading system is called "NEPSE Automated Trading System" (NATS) is a fully automated screen based trading system, which adopts the principle of an order driven market.

Market Timings

Trading on equities takes place on all days of week (except Saturdays and holidays declared by exchange in advance).

The market timings of the equities are: Market Open: - …….. Hours

Market Close: - 15:00 Hours

Note: - The exchange may however close the market on days other than schedule holidays or may open the market on days originally declared as holidays. The exchange may also extend, advance or reduce trading hours when it deems fit necessary.

Securities Available for Trading

NEPSE facilitates trading in the following instruments

A. Shares
- EquityShares
- PreferenceShares

B. Debentures
C. GovernmentBonds
D. MutualFunds

Circuit Breakers

NEPSE has implemented index-based circuit breakers with effect from 2064/6/4 (21 September 2007). In addition to the circuit breakers, price range is also applicable on individual securities.

Index-based Circuit Breakers

The index-based circuit breaker system applies at 3 stages of the NEPSE index movement of 4%, 5% and 6%. These circuit breakers when triggered bring about a trading halt in all equity.

- In case of 4% movement either way, there would be a market halt for 20 minutes if the movement takes place during first hour of trading i.e. 12:00 hours. In case this movement takes after 12:00 hours there will be no trading halt at this level and market shall continue trading.
- In case of 5% movement either way, there would be a market halt for 40 minutes if the movement takes place before 13:00 hours. In case this movement takes after 13:00 hours, there will be no trading halt at this level and market shall continue trading.
- In case of 6% movement in either way, trading shall be halted for the remainder of the day.

Price Range

Price Range is applicable on individual securities. The trading of the individual securities are not halted but allowed to trade within the price range.

The price band is 10% of previous close on either way.During the ATO (At-the-open order) session the range is 5% on either way of Previous Close Price. After the band is 2% on either way of the Last traded price till it reaches to 10% of the previous close.

Trading Location

The trading can be done either from NEPSE‘s trading floor or from the broker‘s office. NEPSE uses sophisticated technology through brokers can trade remotely from their office located inside the Kathmandu valley. This remote trading facility was started from 1 November 2007.

Trading System

NEPSE operates on the “NEPSE Automated Trading System” (NATS), a fully screen based automated trading system, which adopts the principle of an order driven market.

Order Matching Rules

The system adopts principle of order driven market. The best buy order is matched with the best sell order. An order may match partially with another order producing multiple trades. For order matching the best buy order is the one with the highest price and the best sell order is the one with the lowest price. This is because the system views all buy orders available from the point of view of the sellers and all sell orders from the point of view of the buyers in the market. So, of all buy orders available in the market at any point of time, a seller would obviously like to sell at

the highest possible buy price that is offered. Hence, the best buy order is the order with the highest price and the best sell order is the order with the lowest price.

5 SECURITIES BUSINESS

Provision Regarding Persons Engaged in the Business of Securities

Persons who are engaged in the Securities Business are classified as follows [Sec. 63]:

(a) Securities brokers,
(b) Persons engaged in the business of purchase & sale of securities,
(c) Issue house that assists in issue and sale of Public issue of Securities,
(d) Investment Manager,
(e) Investment Advisory Services,
(f) Mutual Fund,
(g) Registrar of Securities and custodial services,
(h) Settlement of Securities transaction,
(i) Market maker,
(j) Any other business notified by the Board as Securities business.

Any company or body corporate who wants to carry any of the above business must obtain a license from the Board. No individual or partnership is allowed to carry on the above business (Sec.56). The company or body corporate desiring to obtain license should submit the following particulars:

(a) Application in the prescribed format,
(b) Particulars regarding the type of business in Securities to be carried and the services to be provided,
(c) Appointing the representative to carry on business and if interested to do business in collaboration with other then detailing the same,
(d) When the business to be carried on should have membership of the stock exchange, then a recommendation letter from the said stock exchange,
(e) Evidence to certify that the applicant is capable of carrying on the security business and any other matter notified by the Board.

The Board, on receipt of application, after examining the same, will issue license in the following circumstances [Sec. 58]:

(a) If it is felt that the applicant is capable of carrying the security business remaining within the Act or Rules & Bye-Law made under the Act and
(b) Training and educational qualification of the chief executive, director and concerned officer appointed to do the securities business on the following matters:
    (i) Financial Status,
    (ii) Educational qualification, training and experience of the concerned work,
    (iii) Experience to carry on securities business,
    (iv) Social status & character.

The broker & Investment advisor can be private limited company. But applicants for other securities business should be public limited company.

The Board may issue licenses quoting which business should not be carried on by the applicant while granting the license, considering the interest of the capital market and the investors.

The Board may put other conditions also while granting the license considering the coalition of capital market, healthy operation of stock market and the interest of the investors. Variation in those conditions from time to time can be made by the Board.

Refusal to Grant License [Sec. 60]

The Board may refuse to givelicense in the following circumstances:

(a) If it is proved that the company has become insolvent unable to repay the loan & liabilities to creditors;
(b) If the required particular to be attached to the applications are not attached;
(c) If it is found that it is not proper the grant the license considering the matters given above regarding financial state, qualification & Social status & character.

Validity of the License [Sec. 61]

The license will be valid for the financial year in which it is first granted. But the same should be renewed within three months from the close of the financial year by paying the annual fee. If it is not so renewed within three months from the end of financial year, then it can be renewed within another three months by paying additional 25% of the fee as penalty. If it is not renewed then the license will be cancelled.

Banks and Financial Institution can carry on securities business only through a subsidiary company. Such subsidiary company can carry on only securities business and no other business.

No License without Notifying the Representative/Agent [Sec. 64]

Any person wishing to carry on securities business should notify its representative to the Board unless such representative is notified, no license will be given. But Issue houses & Security Sales Manager & Investment advisor are not required to notifying any representative to obtain license.

Authorized Representative/Agent [Sec. 65]

Only after the appointment of representative is registered with the Board, he shall be deemed as the authorized representative after his name, address and other necessary particulars are entered in the register of authorized representative maintained by the Board and the Board issues a certificate of authorized representative.

While notifying the Board about the appointment of representative, the consent of the security business owner and the consent of the representative to act also shall be filed with the Board.

If due to any reason the contract between the security business and the authorized representative is cancelled the same should be notified to the Board immediately and the representative should surrender his certificate within 7 days to the Board. The acts done by the Authorized Representative shall be binding on the securities business.

Rights of the Securities Business Person [Sec. 66]

The license granted will not be suspended or cancelled without giving opportunity to explain. While suspending or canceling the license, notice of the same shall be given in writing to the Securities Business person along with reasons for the suspension or cancellation, the date from which the suspension or cancellation will be effective or in the case of suspension, the period of suspension. A person not satisfied with the decision to suspend or cancel the license can appeal to the Court.

Minimum Capital & Financial Sources [Sec. 67]

The securities business should have minimum paid up capital & financial sources as notified. The rules have notified the following:

(a) Broker: Rs. 2,00,00,000
(b) Securities: Rs. 20,00,00,000

If they are not having sufficient capital as notified, they must inform the Board, who can make order either to maintain the capital immediately or any other appropriate direction.

The Board shall keep a register in respect of Securities Business license holders with updated information and the same shall contain the following information:

(a) Name and address of the Security business,
(b) The date of license given,
(c) The nature and type of Security business,
(d) Terms contained in the license,
(e) The name and address of the authorized Representative,
(f) The names and address of the Manager and other officers,
(g) The place where the records & paper relating to Securities business is kept,
(h) Names of the directors, company secretary and shareholders and the number of shares taken by them,
(i) Any other matter considered by the Board as necessary and proper.

Similarly a register of every authorized representative (formal agent) shall bee kept up to date with the following particulars:

(a) Name & address of the authorized representative,
(b) Date when registered as authorized representative,
(c) The name and address of the Security Business appointing as the authorized representative,
(d) Any other matter considered necessary and proper by the Board.

The Security Business shall inform the Board within 7 days in the following cases:

(a) If it has stopped to do the Security business as mentioned in the license,
(b) If any authorized representative has ceased to act as Authorized representative,
(c) If there is any change in any of the particulars provided to the Board.

Principles to be Adopted and Followed

Section 76 provides, the following business principles or standards shall be applicable to all types of securities business:

(a) To keep the transaction transparent and of higher order,
(b) To carry on business with proper skill, attention and effort,
(c) To maintain high profit of the Securities business,
(d) To provide services to the customer according to their requirements after ascertaining their objective of investing in securities,
(e) To provide necessary information and advise that will help to customers to decide, regarding investment in securities,
(f) To avoid conflict of own interest with the interest of the customers and if such occasion arises to inform the customer of the same and to work with the best interest of the customer,
(g) To make adequate arrangements to fulfill the guarantee made in connection with the Securities business,
(h) To keep proper records of the transactions relating to Security business,
(i) To arrange for proper training of the employees in order to develop skilled man power for operating the securities business and
(j) To comply with other principles relating to Securities business as may be notified.

Transaction With Customer

Person carrying on Securities business should comply with the regulation that are notified regarding customer identity (Know Your Customer), opening customer account, money giving & taking and carrying of the transaction.

After entering into a contract for sale, purchase or exchange of securities, Contract Note (CN) should be made before the close of stock market on the next day. The CN should include whether he is acting as agent of the customer or acting on his own account and a copy of CN made on behalf of the customer should be given to the customer.

The Contract Note should contain the following information:
(a) The type of securities business and the address,
(b) If the Securities Business person is acting as principal, then particulars of the same,
(c) Name and address of the person to whom contact note is to be given,
(d) Date of Contract and the date Contract Note is made,
(e) Particulars and quantity of the Security,
(f) Rate per unit of Security,
(g) The consideration to be given under the contract,
(h) The commission and rate of commission to be paid under the contract,
(i) If any fee to be paid, the rate of fee and particulars of the same,
(j) The date of settlement,
(k) Any other matter that may be notified.

Merchant Banker

Known as 'Accepting and Issuing houses' in UK and as 'Investment Banks' in US, modern merchant banks offer a wide range of activities, including portfolio management, credit syndication, acceptance credit, counsel on mergers and acquisitions and insurance, etc.

Of these two classes of merchant banks, the U.S. variant initiates loans and then sells them to investors. Even though these companies call themselves "merchant banks," they have few, if any, of the characteristics of former merchant banks.

Although not defined in U.S. federal banking and securities laws, the term merchant banking is generally understood to mean negotiated private equity investment by financial institutions in the unregistered securities of either privately or publicly held companies. Both investment banks and commercial banks engage in merchant banking, and the type of security in which they most commonly invest is common stock. They also invest in securities with an equity participation feature; these may be convertible preferred stock or subordinated debt with conversion privileges or warrants. Other investment bank services-raising capital from outside sources, advising on mergers and acquisitions, and providing bridge loans while bond financing is being raised in a leveraged buyout (LBO)-are also typically offered by financial institutions engaged in merchant banking.

Merchant banks first arose in the Italian states in the Middle Ages when Italian merchant houses-generally small, family-owned import-export and commodity trading businesses-began to use their excess capital to finance foreign trade in return for a share of the profits. This trade generally consisted of lengthy sea voyages. Thus, the investments were very high risk: war, bad weather, and piracy were constant threats, and by their nature the voyages were long-term and illiquid.

Later, the center for merchant banking shifted from the Italian states to Amsterdam and then, in the eighteenth century, to London, where immigrants from Prussia, France, Ireland, Russia, and the Italian states formed the core of early British merchant banking. Like the Italian and Dutch houses before them, these British houses were generally small, family-owned partnerships, and most of them continued both to trade for their own businesses and to finance the trading by others. By the end of the eighteenth century, however, the British merchant houses had increased in size and sophistication and began specializing in trade, marketing, or finance. As the nineteenth century opened, virtually no mercantile houses remained focused on both trade and finance.

A merchant banker undertakes the following services listed in the Securities laws:
(a) Issue house that assists in issue and sale of Public issue of Securities;
(b) Investment Manager;
(c) Investment Advisory Services;
(d) Market maker - builder

Major Highlights of the Merchant Banker Regulation 2064 to be followed by the Merchant Banker

Functions of Merchant Banker

All or one of the functions mentioned below can be performed by the Merchant Banker
(a) Preparing the prospectus proposal and other details for theissueof securities and carrying out all the work relating to issue management.
(b) Underwriting the securities by entering into an agreement with the issuing Company.

(c) Keeping the record of security holders, performing thetransferof securities, and share registration on behalf of the company.
(d) Arrange for managing the investment by entering into an agreement with the investors.
(e) Provide corporate consultancy service.
(f) A merchant banker is not allowed to perform functions other than those of merchant banking but this will not apply to bank and financial institution.
(g) Authorized merchant banker can deal in other securities as per section 63 of the Securities Act.

Agreement

To provide any merchant banking service a merchant banker has to enter into an agreement with the company to which it is providing such service mentioning rights and liabilities of both the parties and such agreement should be forwarded to the board within 15 days of entering into such agreement. The board may prescribe the format of the agreement.

Joint Merchant Banking Service

A merchant banker may enter into an agreement with other merchant banker to provide service jointly. The agreement between the merchant bankers should be forwarded to the board. The main merchant banker must obtain the consent of company to which it is providing such service on the involvement of joint merchant banker.

Responsibility of Merchant Banker as the Functions conducted by them are as follows:

Responsibility as Issue managers

All the work relating to the issue of securities such as issue and collection of money, allotment, refund of money, distribution of certificate, listing of securities information regarding the issue will be the responsibility of the issue manager.

Responsibility as Share Registrar

Registering the shares in the name of transferee by fulfilling the procedure, certifying the ownership and keeping records of the owners of securities will be the responsibility of the share registrar.

Responsibility as Under writer

If the securities that are underwritten are not sold then the underwriter has to purchase remaining unsold securities and perform all the function relating to the underwriting agreement.

Responsibility as Investment Manager

To enter into an agreement with the investor for managing investment, open customer account and purchase and sell securities for the client as per the agreement and performing other function relating to investment management will be the responsibility of investment manager.

Transaction limit

The board will from time to time prescribe the transaction limit on the basis of paid up capital and Net asset of the merchant banker.

Service fee

As prescribed in annex-10 of merchant Banking regulation -2064 the service fee will be as follows:

(a) For public issue and issue by circular maximum of 2% of the amount for which the issue has been managed may be charged as servicefee. However, such service fee shall not Rs. 100,000.
(b) For public issue and issue by circular when underwritten maximum of 4% of the amount underwritten may be charged as service fee.
(c) For transfer of securities Rs.10 per transfer and for registration of securities the annual service fee will be as provided in the agreement between the Company & the Merchant banker.
(d) In the case of investment management and corporate consultancy, the service fee will be as per the agreement between the Merchant banker and the client.

Application for License

Every company interested in conducting the business of merchant banking must give an application to the board with prescribed fee in prescribed manner.

Addition of Business

If any business is to be added then he should inform the board along with the prescribed fees in prescribed format along with following documents.

(a) Feasibility study report.
(b) Business plan for coming three years.
(c) The board resolution of the directors for addition of business.
(d) The details that the paid up capital is enough for the addition of business.
(e) The original copy of license of merchant banker.
(f) The manpower & infrastructure arrangement for the new business.

The board may inspect the infrastructure and if satisfied on payment of the prescribed fees. The board may issue a new license instead of the old one thus canceling the old one.

Renewal of License

Every Merchant Banker must renew its license 3 within month of the expiry of fiscal year. Renewal fee is as follows:

Types of Merchant Banking Business	Amount
Issue Management	150,000
Share registration	100,00
Underwriting	150,000

Investment Management	100,00
Corporate Consultancy service	150,000

Minimum Paid up Capital & Financial Source

The minimum paid up capital according to the function performedbythe merchant banker is as follows:

Types of Merchant Banking Business	Minimum Paid up Capital
(1) IssueManagement	5 crore
(2) Shareregistration	3 crore
(3) Underwriting	7 crore
(4) InvestmentManagement	5 crore
(5) Corporate consultancy service	3 crore

If all the functions are performed then Rs. 20 crore will be the required minimum paid up capital.

Disqualification of Promoter

Following persons are disqualified from being a promoter:

(a) Person who has been found guilty of offence involving moralturpitude.
(b) Person who has been found guilty for fraudulent action or corruption by the court and five years have not elapsed since then.
(c) Person declared insolvent and five years have not elapsed since then.
(d) Person who has been black listed by the Loan Information Centre.
(e) A director of the company who has previously raised money through issue of securities to the public and not listed the securities or the listing of such securities has been cancelled.
(f) A person who has ownership in other securities business.
(g) If he is a foreign person then the permission has not been taken as per the prevailing law for foreign investment and other prevailing law or from the government of Nepal.

Qualification of Directors

Following should be the qualification of the Directors or Chief Executive Officer:

(a) Including the chairman of the Board of Directors at least two- third of the directors and the chief executive officer should be a graduate in economics, commerce or finance or accounts or management or commercial law or should have a chartered accountancy degree and at least years' experience of working in the field of commerce or industry or securities market or in the field of finance management or commercial law.
(b) Must be a NepaleseCitizen. However, if permission is given by the Government of Nepal then even a foreign citizen may be the director or a chief executive officer.

Qualification of Directors and Chief Executive Officer to be maintained

The qualification of directors and chief executive must be maintained throughout the period of functioning as a merchant banker. If the qualification is violated then he will be assumed to have vacated the office. In such case the merchant banker should inform the board and appoint another person with the qualification within 30 days and inform the board.

Disqualification of Directors and Chief Executive Officer

Following are the disqualifications of the Directors or Chief Executive Officer:

(a) Person with mental disorder or who is insane,
(b) Person who is in the influential position in the board, securities business or securities broker or central depository service or other merchant banker or credit rating institution,
(c) Person who has been found guilty in offence involving moralturpitude,
(d) Five years have not been completed from the date from which the person or the company or the company in which he was a director or chief executive officer has been declared insolvent due to the inability to pay debt,
(e) The person or the company or the company in which he was a director or chief executive officer who has been black listed by the Loan Information Centre,
(f) A director or chief executive officer of the company who has previously raised money through issue of securities to the public and not listed the securities or the listing of such securities has been cancelled,
(g) Securities Dealer whose license has been cancelled by violating the law relating to securities,
(h) A person who has ownership in other securities business.

6 COLLECTIVE INVESTMENT SCHEME

A collective investment scheme is an arrangements with respect to property of any description, including money, the purpose or effect of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of it or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property or sums paid out of such profits or income.

Sec. 2(w) of the Securities Act defines "Collective investment scheme" means such an investment fund, unit trust or similar other participatory fund management program as specified by the Board, from time to time as may be operated by a scheme manager in accordance with this Act in order to distribute returns, to the participants of the concerned program proportionately, accrued from the efficient investment service on saving investment amount which has been undertaken in custody of the manager and so mobilized that various persons or bodies that have participation in it.

No person shall, without obtaining license from the Board, operate mutual fund or any of the following activities:

(a) To advertise inviting person to be participant in mutual fund or give proposal to be participant in any such plan either directly or indirectly;
(b) To give opinion, advice or consultation for participation in any such plan.

Issuance of permission to operate collective investment scheme [Sec. 72]

A scheme manager shall, prior to operating the collective investment scheme to be managed and operated by him/her, make an application to the Board in such format and accompanied by such details and fees as may be prescribed in order to register such scheme with the Board and obtain permission to operate the same.

If an application is received, the Board shall, if it considers appropriate to grant permission upon conducting necessary inquiry into the matter, register the collective investment scheme and grant license within 90 days from the date of receipt of application.

On receipt of application, the Board shall examine and make enquires and ask for details & information and documents and until such details, information and documents are received, no license will be granted.

While granting permission/license for the collective investment scheme, the Board may direct to give the participants certificate of participation or other identification and can issue to the any terms and conditions which can be amended by the Board from time to time as may be necessary.

The Scheme Manager may operate in one name or different names or single or various types of plans of Mutual fund, keeping in mind the interest and benefit of the participants. Before starting any such plan, the Scheme Manager shall enter into an agreement with a depository, who will keep custody of the investments made by the mutual fund.

Cancellation of License [Sec. 74]

The Board may cancel the permission/license issued to operate a collective investment scheme in the following cases:

(a) If the necessary terms for operating the fund are not fulfilled in a satisfactory manner;
(b) Keeping the interest of the participants if it is seen that it is not appropriate to allow the fund to operate;
(c) If scheme manager and the depository does any act in contravention of this Act and Rules and bye laws made under the Act or have provided false information to the Board regarding the plan.

While canceling the permission/license, the Board may make necessary enquiries with the manager concerned with the plans, depository, directors and other concerned employee. While canceling the approval, the Board may, keeping in mind the interest of the participants cause such fund to be operated by any other scheme manager or settle the accounts of the participants by realizing the investments and its returns as directed by the Board.

Regulations for the Management of Mutual Funds

The Board may notify the manner of conducting the operation of the collective investment scheme and other arrangements to be followed by the managers with a view to protect the interests of the participants in such schemes. For the purpose of the operation of the collective investment scheme, the Board may make regulation for the following matters.

(a) The conditions and procedure relating to registration and approval of the collective investment scheme,
(b) The constitution of collective investment scheme, function and duties of manager and depository, rights and duties of participants,
(c) Promotion of units, marketing arrangement and distribution,

(d) Issue of units and discount,
(e) Management of the plan schemes and depository services,
(f) To make the investment and loans of the fund properly regulated and organized,
(g) Keeping records with a view to disclosing clearly the transactions and the financial position related to collective investment schemes and supervision of accounts and other necessary records,
(h) Periodical report related to collective investment scheme and submitting the same to the participants of such scheme and to the board,
(i) The charges, remuneration, fee to be taken for managing the fund and providing the depository services,
(j) Management of credit and investment of collective investment scheme.

While making the above regulations, different types of regulations can be made for different type of collective investment scheme. The regulation may relate to the Investment pattern of different types of mutual funds, receiving applications, charges for entering and leaving, sale and repurchase of units, time upto which the unit could be sold and price received, etc.

Different Types of Collective Investment Scheme

An open-ended fund operated by an investment company which raises money from unit holders and invests in a group of assets, in accordance with a stated set of objectives. Mutual funds raise money by selling units of the fund to the public, much like any other type of company can sell stock in itself to the public.

Mutual funds then take the money they receive from the sale of their units (along with any money made from previous investments) and use it to purchase various investment vehicles, such as stocks, bonds and money market instruments. In return for the money they give to the fund when purchasing units, unit holders receive an equity position in the fund and, in effect, in each of its underlying securities. For most mutual funds, unit holders are free to sell their shares at any time, although the price of a unit in a mutual fund will fluctuate daily, depending upon the performance of the securities held by the fund. Benefits of mutual funds include diversification and professional money management. Mutual funds offer choice, liquidity, and convenience, but charge fees and often require a minimum investment.

A closed-end fund is often incorrectly referred to as a mutual fund, but is actually an investment trust.

There are many types of mutual funds, including aggressive growth fund, asset allocation fund, balanced fund, blend fund, bond fund, capital appreciation fund, clone fund, closedfund, crossover fund,equity fund, fund of funds, global fund, growth fund, growth andincome fund, hedge fund, income fund, index fund, international fund, money market fund, municipal bond fund, prime rate fund, regional fund, sector fund, specialty fund, stock fund, and tax-free bond fund.

7 PUNISHMENT

Punishment [Sec. 101]:

Section 101 of the Act has provided different punishment in case of violation of this Act, Rules, Bye-laws or directions of the Board which are as follows:

S.N.	Offence	Punishment
1	A person who commits an insider trading as referred to inSection 91	- Fine equal to the amount in controversy, or - Imprisonment for a term not exceeding 1 year or - Both
2	A person who commits any act referred to in Sections 94, 95 and 96	- Fine of Rs 50,000, or - Imprisonment for a term not exceeding one year, or - Both, And, where anyone has suffered any loss or damage from such an act, such loss or damage has also to be recovered.
3	A person who commits any act referred to in Sections 97, 98, 99 and 100	- Fine of Rs 1,00,000 to 3,00,000, or - Imprisonment for a term not exceeding two years or - Both punishments, And, where anyone has suffered any loss or damage from such transactions, such loss or damage shall also be recovered.
4	If anyone knowingly or with *mala fide* intention, does not maintain, make, prepare or submit such accounts, books, statements, reports, notices, information or similar other documents as required to be maintained, made, prepared or submitted under this Act or the Rules or Bye-laws framed under this Act within the time specified for the maintenance, making preparation or submission of such accounts, books, statements, reports, notices or information or if one makes, prepares or retains false statements or documents	Board may punish such a person with a fine of Rs 50,000 to 200,000.
5	If anyone knowingly commits any act in contravention of this Act or the Rules or Bye-laws framed	Board may punish such a person with a fine of Rs 50,000.

	under this Act or the orders or directions issued under this Act and thereby causes any loss or damage to anybody corporate, stock exchange, securities business person or investor	If anyone has suffered any loss or damage from such act, the Board may also cause the recovery of compensation for actual loss or damage.
6	If anyone issues securities, carries on or causes to be carried on a stock exchange or operate or causes to be operated securities transaction in the capacity of a securities business person without fulfilling such requirements as required to be fulfilled under this Act or the Rules or Bye-laws framed under this Act	Board may punish such a person with a fine of Rs 50,000 to 150,000.
7	If any person violates this Act or the Rules or Bye-laws framed under this Act or any orders or directions issued thereunder or any terms and conditions specified by the Board or fails to do any such act as required to be done by such a person or commits any such act as required not to be done,	Board may punish such a person with a fine of Rs 25,000 to 75,000.

CHAPTER- 4

BANKS AND FINANCIAL INSTITUTIONS ACT, 2073

1 INTRODUCTION

Banks and Financial Institutions Act, 2073 was promulgated on 10th of Baisakh, 2074. It repealed the previous Act of 2063. It shall extend to the whole of the State of Nepal and also apply to all branches or contact offices opened anywhere outside Nepal by banks or financial institutions established in Nepal.

The Act is made to amend and consolidate prevailing legislations relating to banks and financial institutions by timely reforms with the following objectives as outlined in the preamble to the Act:

- To promote the trust of the general public in the overall banking and financial system of the country,
- To protect and promote the rights and interests of depositors,
- To provide quality and reliable banking and financial intermediary services to the general public through healthy competition among banks and financial institutions,
- To minimize risks relating to the banking and financial sector,
- To boost and consolidate the economy of the State of Nepal by liberalizing the banking and financial sectors,
- To make necessary legal provisions relating to the establishment, operation, management and regulation of banks and financial institutions.

In this Act, following terminologies are defined as follows:

(a) Significant ownership: Significant ownership means a situation where a person or an institution individually or jointly with other persons or institutions holds 2% or more than 2% of paid up capital of any banks or financial institutions or a situation where there is influence over the management of banks or financial institutions because of the share ownership.

(b) Family: Family means the director's husband or wife, son, daughter-in-law, daughter, adopted son, adopted daughter, father, mother, step-mother and elder brother/sister-in-law, younger brother/sister-in-law, elder sister/younger sister to be maintained by him or her. But the term does not include family members doing their own occupation/business living separately after partition.

(c) Financial Interest: Financial Interest means a situation where ten percent or more of the total paid-up capital of any firm, company or corporate body is held by any promoter, director or chief executive or shareholder holding one percent or more of the shares or family member of such person or any individual, company or corporate body empowered to nominate a director, whether singly or taken together than interest of such person or persons owning ten percent or more shares in an institution is deemed to have financial interest and this term also includes interest in financial transaction as financial interest, considering its nature and situation, as specified by Rastra Bank from time to time.

(d) Associate Person: Associate Person means the director, officer or family member of such persons or person, firms, company or institution or their beneficiary having significant ownership in any firms, company or institution.

Incorporation of Banks or Financial Institutions[Sec. 3]

A person who is desirous of incorporating a bank or financial institution to carry on financial transactions pursuant to this Act may do so by getting such bank or financial institution registered as a public limited company in accordance with the Companies Act, 2063.

Section 4 of Companies Act, 2063 provides, if prior approval or license has to be obtained from anybody under the prevailing law prior to the registration of a company carrying on any particular type of business or transaction pursuant to the prevailing law, such approval or license shall also be submitted to the Office of Company Registrar (OCR) for the incorporation of the company. As bank or financial institution is regulated by Nepal Rastra Bank, it requires prior approval of the Rastra Bank for the incorporation. Office of Company Registrar (OCR) shall register the bank or financial institution only after it has obtained prior approval from the Rastra Bank.

The Act further provides that the bank or financial institutions that are in operation before commencement of this Act, shall not be required to register.

Prior Approval of Nepal Rastra Bank to Incorporate Bank or Financial Institution [Sec. 4]

Section 4(1) provides, a person desirous of incorporating a bank or financial institution shall make an application, accompanied by the following documents to Nepal Rastra Bank for prior approval:

- Memorandum of Association of the proposed bank or financial institution,
- Articles of Association of the proposed bank or financial institution,
- Feasibility study report of the proposed bank or financial institution,
- Personal details of the promoters in the form prescribed by Nepal Rastra Bank,
- A certified copy of the agreement, if any, entered into between the applicants for the incorporation of bank or financial institution,
- Description about applicant's source of investment and evidence of tax clearance up to the fiscal year immediately preceding the making of application pursuant to this section,
- Description about whether or not the applicant is insolvent in Nepal or in foreign, whether or not loan taken from any bank or financial institution, whether or not black listed for any transactions with bank or financial institution, if black listed, whether 3 years has elapsed or not from the date of release from black list,
- Self-declaration that no action or punishment has been taken against applicant in Nepal or in foreign for any fraud, forgery, or against any such activity that is treated as offence as per prevailing law,
- Description about whether or not any actions has been taken against the applicant by any regulatory body or supervisory body in Nepal or in foreign, suspension or cancellation of

license of company or institution in which applicant is involved or such company or institution is under compulsory liquidation or is in process of compulsory liquidation,

- Description about applicant's family member name, surname and relation as well as significant ownership or significant status and description about whether they are directors in any institution, working as an officer or employee along-with their designation, if any.

  However, if the applicant is a corporate body than description about person having significant ownership or status holder in such institution, last three years audited financial statement and tax clearance certificate of such corporate body shall also be required to be attached.
- Written authority provided to the Rastra Bank to investigate or cause to investigate about applicant's financial and professional background or exchange or cause to exchange such information,
- Commitment of security deposit to the extent prescribed by Rastra Bank,
- Other description and documents as prescribed by Rastra Bank from time to time.

Note: "Promoter" means a person who, having consented to subscribe at least one share, signs the memorandum of association and the articles of association for the establishment of a bank or financial institution pursuant to this Act.

Sub-section 2 provides, if an application is made for prior approval, Nepal Rastra Bank shall grant approval to incorporate such bank or financial institution within 120 days after the making of application, if it finds appropriate to grant approval upon examination of the application and submitted documents.

Sub-section 3 provides, prior approval for incorporation of bank or financial institution shall not be given to a firm or company whose significant ownership is with following person or such person's family member:

- Regulatory action taken by Rastra Bank,
- Punished under banking offence,
- Punished for cheating, fraud, forgery,
- Punished for financial investment in money laundering and terrorist activities,
- Punished for corruption related offence,
- Punished for serious nature offence like human trafficking, abduction, kidnapping, and rape.

Prior Approval of Nepal Rastra Bank to Incorporate Bank or Financial Institution in Foreign Investment [Sec. 5]

The Act has encouraged to foreign bank or financial institution to incorporate bank or financial institution in Nepal. However, it permits for incorporation of such bank or financial institution in Nepal only in joint investment with a corporate body incorporated in Nepal or with a citizen of Nepal, or as a subsidiary company subscribing shares as prescribed by Nepal Rastra Bank. Section 5(1) provides, such bank or financial institution shall along with the documents as prescribed under section 4(1), submit following additional documents to Nepal Rastra Bank for prior approval.

- Copy of Memorandum of Association, Articles of Association of foreign bank or financial institution, certificate of registration of foreign bank or financial institution in respective nation and capital structure,
- Copy of license obtained for doing banking and financial transactions in respective nation of foreign bank or financial institution,
- Detail about the principal place where it carries on its transactions,
- Certified copy of last 3 years audited balance sheet and profit and loss account of foreign bank or financial institution,
- Proposed business plan, business strategy in Nepal and details regarding the types of operation activities, internal control and risk management,
- Decision made as per prevailing law of respective nation of foreign bank or financial institution regarding incorporation of a bank or financial institution in Nepal, and authority provided from that nation's regulatory body.

Nepal Rastra Bank may grant its approval to a foreign bank or financial institution for incorporation of the bank or financial institution in joint venture or within the prescribed share limit within one hundred twenty days after making of an application, with or without prescribing any conditions, if it deems appropriate to grant approval upon examination of the application and enclosed documents.

Foreign bank or financial institution on prior approval from Nepal Rastra Bank, may have share ownership in national bank or financial institution that is in operation, in the form of joint venture by fulfilling the criteria prescribed by Nepal Rastra Bank. Notwithstanding anything contained in this Act, if any foreign bank or financial institution or other foreign institution has made investment in a bank or financial institution as per prevailing law before commencement of this Act, the investment in such bank or financial institution shall be deemed to have continued.

Prior Approval of Nepal Rastra Bank for Opening Branch Office of a Bank or Financial Institution [Sec. 6]

If any international rated foreign BFI desires to open branch office in Nepal for doing banking and financial transaction or non-banking financial transaction, prior approval of Nepal Rastra Bank is required for opening such branch office. An application shall be required to be submitted to Rastra Bank along with capital and fee as prescribed by Rastra Bank. The applicant shall submit following additional documents and details along with the documents as prescribed under sub-section (1) of section (5):

- Written commitment from Board of Directors declaring that the amount required in fulfillment of the total liability, in relation to business work activities of branch or representative or liaison (contact) office of foreign bank or financial institution in Nepal shall be made available at time as required by Rastra Bank,
- Description of place where proposed branch office of foreign bank or financial institution will be located,

- Detail of possible officers of proposed branch office of foreign bank or financial institution.

Nepal Rastra Bank shall grant approval to foreign bank or financial institution to open branch office in Nepal within 120 days after the making of application, with or without prescribing any conditions, if it finds appropriate to grant approval upon the examination of the application. After getting prior approval, such foreign bank or financial institution shall register the branch office as per prevailing company law.

After registration of the branch office as per prevailing company law, for the purpose of doing banking and financial transactions in Nepal, the branch office of foreign bank or financial institution shall make an application accompanied by the following documents and the prescribed fees to the Rastra Bank for approval:

- Registration certificate of branch office registered pursuant to prevailing company laws for doing banking and financial transactions in Nepal,
- Approval or consent letter obtained from government or central bank or regulatory entity as per law of respective nation of such foreign bank or financial institution to open branch office in Nepal by foreign bank or financial institution,
- Description of any differences in the matters required to be fulfilled as per this Act, after making an application to Rastra Bank for approval or after getting prior approval from Rastra Bank for incorporation of branch office of a foreign bank or financial institution in Nepal,
- Such other information and particulars as required by Rastra Bank.

The Rastra Bank shall, if it finds appropriate to grant approval upon the examination of the application, grant approval to branch office of such foreign bank or financial institution to do banking and financial transactions within 90 days after the making of application.

Bank or Financial Institution may open branch office outside Nepal after getting approval from Rastra Bank. Rastra Bank shall prepare necessary policy from time to time in relation to opening of branch office outside Nepal.

Power of Nepal Rastra Bank to Refuse to Grant Prior Approval [Sec. 7]

Section 7 provides, Nepal Rastra Bank may refuse to grant prior approval for the incorporation of any bank or financial institution or to open branch office of foreign bank or financial institution in any of the following circumstances:

- If the name of the proposed bank or financial institution or the financial transactions to be carried on by it appears to be undesirable in view of public interest, religion, nationalities or communities,
- If the objectives of the proposed bank or financial institution are contrary to the prevailing laws,
- If the incorporation of the proposed bank or financial institution seems to be technically inappropriate,

- If a study of the feasibility study report, particulars and documents and information on other infrastructures submitted by the proposed bank or financial institution does not provide a ground to believe that it can carry on financial transactions in a healthy and competitive manner,
- If all the promoters of the proposed bank or financial institution have not signed the memorandum of association and articles of association, also setting out their names, addresses and number of shares to be subscribed by him or her, in the presence of witness, and the name and address of the witness has not been set out,
- If per person share investment limit and share ownership proportion as prescribed by Rastra Bank from time to time has not been fulfilled,
- If it is against the policy issued by Rastra Bank related to incorporation and licensing of banks or financial institutions,
- If other condition prescribed by the Rastra Bank is not fulfilled.

If Rastra Bank refuses to grant prior approval to proposed bank or financial institution in any of the circumstances referred above, it shall give a notice thereof to the applicant.

2 PROVISION RELATING TO SECURITIES TRANSACTIONS

Bank or financial institution, being a public company, shall publish the prospectus prior to public issue of securities. Thus, it shall obtain approval in accordance with the laws in force relating to securities and have the prospectus registered with Rastra Bank & OCR. The bank or financial institution, or anybody acting on behalf of such bank or financial institution shall not publish the prospectus of such bank or financial institution until the prospectus is registered with Nepal Rastra Bank and OCR. The Rastra Bank and OCR shall register a prospectus only after it receives information in writing that approval has been given by the Securities Board in relation to the registration of the prospectus.

Allotment of Shares

Section 9(1) provides, a bank or financial institution shall set aside at least 30 % of its total issued capital for subscription by the general public. However, this provision may not be required in context of bank or financial institution and infrastructure development bank to be incorporated under significant ownership of Government of Nepal. Here general public shall represent natural person.

The shares allotted to the general public shall be sold to the general public within the stipulated time. The shares that could not be sold in such a manner may be sold to any other firm, company or institution. Section 9(3) provides, the bank or financial institution may set aside 0.5% shares, except that of the limit referred to in sub-section (1), to its employees.

A bank or financial institution to be incorporated in joint venture with a foreign bank or financial institution or other foreign institution or infrastructure development bank shall allot the shares to the general public as specified by the Rastra Bank.

Section 9(4) provides, the bank or financial institution may, if it wishes, convert the shares into ordinary shares having fulfilled the process specified by the Rastra Bank in such manner as not to be the share ownership of the promoter shares group less than 51 percent.

"Promoter shares group" means the promoter shares group as prescribed by the Rastra Bank. "Ordinary shares group" means the shares groups other than the promoter shares group.

Section 9(7) provides, while inviting application from the general public for the subscription of its shares, every bank or financial institution shall demand payment of 100 % amount of the face value of its shares along with application.

Sell or Pledge of Shares by Promoters

The Act has provision\s for lock in period for sale or pledge of promoter shares. Section 11 provides, the promoter of a bank or financial institution shall not be entitled to sell or pledge any share registered in his or her name for at least five years from the date of commencement of financial transactions. However, in cases where a special circumstance arises due to emergence of any obstruction or hindrance in the operation of a bank or financial institution or a promoter shareholder is included on the blacklist owing to transactions with another bank or financial institution, shares may be sold or purchased amongst promoters by obtaining approval from the Rastra Bank.

Here, "special circumstance" means a situation where to hold a meeting of the Board of Directors has not been possible due to lack of a quorum for a consecutive period of three times or a situation where no decision been made possible because of disputes amongst its directors.

If a promoter wishes to sell or pledge the shares held in his/her name after five years from the date of commencement of financial transactions and after shares are issued to the general public by the bank or financial institution, he or she may sell or pledge such shares by obtaining approval from the Rastra Bank on the condition that such shares shall remain in the promoters' group. However, approval of the Rastra Bank shall not be required while selling or pledging shares by a promoter having subscribed the shares of less than two percent of the paid up capital.

After completion of a period of ten years of transactions by a bank or financial institution, the promoter shares may, gradually be converted into ordinary shares with the approval of the Rastra Bank by giving due consideration to the impact it may have on the capital market, banking and the overall financial sector.

In case a company or corporate body subscribes promoter shares, prior approval of Rastra Bank shall be obtained before making alterations in substantial ownership shareholders, sale or transfer of shares of such company or corporate body. However, prior approval from Rastra Bank shall not be necessary to sell or pledge share for company or corporate body subscribing share less than two percent of paid up capital of a bank or financial institution.

Restriction on Dealing in Securities Transactions

The Act prevents insider trading. Section 12(1) provides, the Director, Chief Executive, Auditor, Company Secretary of a bank or financial institution or a person directly involved in the

management and account of a bank or financial institution shall not buy or sell, mortgage or cause to be mortgaged, cause to be bought or sold, accept or give in the form of a gift, transfer or transact the securities of the concerned bank or financial institution or of its subsidiary company in his/her name or in name of any member of his/her family or a firm, company or institution under the control of such person or to any other person until he/she holds such a position or until one year from the date of retirement from such position.

However, it shall not be deemed to restrict the sell, purchase or transfer of securities among Directors to Directors or Directors to Promoters with the approval of the Rastra Bank, while issuing bonus shares, rights shares or the shares allotted for employees or issuing new shares, or while implementing a directive of the Rastra Bank or while selling the entire share having in any bank or financial institution under own ownership by any director or any corporate body having power to appoint director or while merging or amalgamating banks or financial institutions in each other or while acquiring all assets or liabilities of one bank or financial institution by another bank or financial institution or while carrying out purchase or sale of securities among promoter directors or directors to directors with the approval of the Rastra Bank in cases of emergence of any hurdle in the operation of the bank or financial institution or while carrying out purchase or sale or transfer of shares during the process of reformative or settlement process of a problematic bank.

Section 12(2) provides, if any person does any act in contravention of above, the concerned bank or financial institution shall forfeit and sell such shares as prescribed by Rastra Bank.

Prohibition on Purchase by Bank or Financial Institution of its Own Shares

The Act generally restricts to any bank or financial institution to purchase its own shares. At the same time it also prohibits bank or financial institution to lend moneys against security of its own shares.

Section 13(2) provides, in the following circumstances a bank or financial institution may with the approval of the Rastra Bank, buy back its shares out of its free reserves available for being distributed as dividends not exceeding the percentage prescribed by the Rastra Bank.

- If the shares issued by the bank or financial institution are fully paid up,
- If the shares issued by the bank or financial institution have already been listed in the securities market,
- If the buy-back of shares is authorized by the articles of association of the concerned bank or financial institution ,
- If a special resolution has been adopted at the general meeting of the concerned bank or financial institution authorizing the buy-back,
- If the ratio of the debt owed by the bank or financial institution is not more than twice the capital and general reserve fund after such buy-back of shares. Here, "Debt" means all amounts of secured or unsecured debts borrowed by the bank or financial institution.

- If the value of shares to be bought back by a bank or financial institution is not more than twenty percent of the total paid up capital and general reserve fund of that bank or financial institution,
- If the directives regarding capital fund issued by Rastra Bank to bank or financial institution, is followed after such buy-back of shares,
- If the buy-back of shares is not in contravention of the directives issued from time to time by the Rastra Bank in this respect.

A bank or financial institution shall make an application to the Rastra Bank to obtain approval for the buy-back of shares setting out the following matters:

- The reason, necessity, time and ways for the buy-back of shares,
- A statement of evaluation of possible impacts on the financial situation of the bank or financial institution as a result of buy-back of shares,
- The class, value per share and number of shares intended to be bought back,
- The maximum or minimum amount required to buy back shares and source of such amount,
- Such other matters as specified by the Rastra Bank in respect of buy-back of shares,
- Such other necessary matters as required to be disclosed under the laws in force.

The Rastra Bank shall, if it finds appropriate to grant approval upon the examination of the submitted documents, grant approval to bank or financial institution to buy-back its own shares. On receipt of the approval of the Rastra Bank, the concerned bank or financial institution may buy back its shares in any of the following manners, within 6 months after the date of receipt of such approval or 12 months of the adoption of a special resolution at the general meeting, whichever occurs later:

- Purchase from the securities market,
- Purchasing from the existing shareholders on a proportionate basis.

If a bank or financial institution buys back its own shares, it shall file with the Rastra Bank a return containing the number of shares bought back, amount paid for the same and other necessary details within 30 days of the date of such buy-back. There shall be established a separate capital redemption reserve fund, to which a sum equal to the face value of the shares bought back shall be transferred and the amount of such fund shall be maintained as if it is the paid-up capital. The bank or financial institution shall cancel the shares so bought back within 120 days of the date of such buy-back.

3 PROVISIONS RELATING TO BOARD OF DIRECTORS AND CHIEF EXECUTIVE

Formation of Board of Directors

Section 14 provides, a bank or financial institution shall have a Board of Directors consisting of a minimum of 5 and a maximum of 7 directors.

The director shall be appointed by general meeting of bank or financial institution, subject to this Act and articles of association. However,

(a) The directors shall be appointed by the promoters pending the holding of the first annual general meeting of the bank or financial institution,
(b) If the office of any director is vacated before holding of annual general meeting, the board of directors shall appoint another director in that vacancy until next annual general meeting,
(c) In the case of a corporate body subscribing shares, such body may appoint a director in proportion of the shares and while appointing such a person, same person shall not be appointed as a director in more than one bank or financial institution,
(d) Notwithstanding anything contained in (c), nothing shall prevent from appointing a person, who is a Director in any bank or financial institution as Director of an Infrastructure Development Bank.

The Board of Directors shall appoint at least one independent director from amongst the persons having the experience and qualification as pursuant to section 17 and this information should be communicated in the first general meeting to be held after such appointment. However, promoter, director or shareholder subscribing more than 0.1% share of bank or financial institution shall not become an independent director. The Act further restricts more than one member of a family to become a director or independent director of any bank or financial institution at the same time. A person chosen by the directors from among themselves by a majority decision shall be the chairperson of the Board of Directors.

A company, corporate body, foreign bank or financial institution which has subscribed shares of a bank or financial institution may, while appointing a director in proportion to the shares it has subscribed, appoint an Alternate Director to work in the absence of the Director.

The tenure of office of a director shall be as provided in its articles of association, but not exceeding 4 years and he or she may be eligible to be reappointed or re-nominated. However, an Independent Director may be appointed for only one term of office. The section further provides, the Executive Chairperson or Managing Director appointed after the commencement of this Act shall remain in office only for two consecutive terms.

Qualification of Directors

Section 16 provides, a person has to possess the following qualification in order to be eligible for appointment as director:

- Having gained at least 5 years of experience in foreign or domestic bank or financial institution or in related corporate institution sector as a director or officer, or as an officer level in Government of Nepal, or
- Having acquired bachelor's degree and having gained at least 3 years of experience in foreign or domestic bank or financial institution or related corporate institution sector as a director or officer or as an officer level in Government of Nepal, or
- Having acquired master's degree in related subject as prescribed.

The educational qualification and experience of the directors of class 'D' financial institutions shall be as prescribed by the Rastra Bank from time to time.

Section 17 provides qualifications of independent director. The bank or financial institution shall appoint an independent director from amongst the person having following qualification and experience:

- In case of class 'A' bank or class 'B' national level development bank, person having master degree in subject as prescribed by Rastra Bank and gained experience as prescribed by Rastra Bank,
- In case of class 'B' development bank other than class 'B' national level development bank and class 'C' financial institution, person having bachelor degree in subject as prescribed by Rastra Bank and gained experience as prescribed by Rastra Bank,
- In case of class 'D' micro-finance financial institution, person having qualification and experience as prescribed by Rastra Bank.

Disqualification of Directors

Section 18(1) provides, the following persons shall not be eligible to become a director of a bank or financial institution:

(a) Who is below 25 years of age,
(b) Who is unsound mind or insane,
(c) Who is declared insolvent in Nepal or foreign, being unable to pay debt to creditors,
(d) Who has been blacklisted or is in defaulter list in connection with any transaction with bank or financial institution in Nepal or in foreign, and a period of at least 3 years has not elapsed after his or her name has been removed from such defaulter list or blacklist,
(e) Who is a serving director of a bank or financial institution or any corporate institution carrying on transactions relating to any kind of deposit collection and insurance related business or an employee serving in such institution,
(f) Who is a borrower or serving auditor or advisor of concerned bank or financial institution or a partner in any kind of contract agreement with the bank or financial institution or person, firm and company having self-interest,
(g) Who has acquired the membership of the stock exchange to act as a securities business person or merchant banker,
(h) Who is serving as a director in licensed institution,
(i) Who has not subscribed the minimum number of shares required to be subscribed to be eligible for appointment as a director pursuant to the articles of association of the concerned bank or financial institution,
(j) Who is a serving employee of the Government of Nepal or corporate body owned by Government of Nepal or Rastra Bank or bank or financial institution, However, this provision shall not be applicable to the nomination made by the Government of Nepal or institution owned by Government of Nepal or Rastra Bank or Bank or Financial Institution as a director of micro-finance or infrastructure development bank of which shares have been purchased by it.

(k) Who has failed to pay the tax pursuant to the laws in force,
(l) Who is convicted by Nepalese court or foreign court for theft, cheating, fraud, forgery, corruption, criminal offense involving moral turpitude or banking offense and sentenced (sent to prison) thereof, and a period of 10 years has not elapsed from the expiry of the sentence,
(m) Who is punished by regulatory body for activities against law pursuant to the laws in force or a period of 5 years has not elapsed from the expiry of such punishment,
(n) In case of independent director, if he or she is a promoter or owns more than 0.1% of shares of concerned bank or financial institution,
(o) Whose imprisonment sentence is not completed, fine is unpaid as per the decision of court or government due is not paid.

Section 20 provides, a person holding constitutional position shall not hold the position of a director or executive chief, so long as he/she is holding such a position.

No person shall continue to hold the office of director in a bank or financial institution, in any of the following circumstances:

- Not having qualification pursuant to section 16 or 17 or disqualified under section 18,
- If shareholders holding at least 51 % shares of a group, proposes a resolution in the general meeting to remove the director who was nominated as a director from the same group and the resolution is passed by majority, Here, "Group" means promoter group and ordinary (general public) shareholder group.
- If the resignation tendered by the director is accepted,
- If he or she does any act prohibited by this Act or prescribed by Rastra Bank from being done by a director,
- If the Rastra Bank directs to remove the director for being disqualified to remain in the post of director because of his activity against the interest of depositors or bank or financial institution.

Meetings of Board of Directors [Sec. 21]

Meetings of the Board of Directors shall be held at least 12 times in a year. However, the interval between any two meetings shall not exceed sixty days. The chairperson shall call meeting at any time if at least one-third of the directors request for the same in writing along with the subject of discussion.

Meetings of the Board shall be presided over by the chairperson. In the absence of the chairperson, the meeting shall be presided over by a director selected by a majority of the director's form amongst themselves. No meeting of the Board of Directors shall be held unless it is attended by at least 51 % of the total number of directors. The decision of a majority in the meeting of the Board of Directors shall be binding. In the event of tie, the person chairing the meeting may exercise the casting vote.

Minutes regarding the names of directors present in the meeting of board of directors, the subjects discussed and the decisions taken thereon shall be recorded in a separate book, and such minute book shall be signed by all directors present in the meeting. However, if any director puts forward any opinion opposed to or differing from the decision in the course of discussions on any subject in a meeting, he or she may mention the same in the minute book.

Functions, Duties and Power of Board of Directors [Sec. 22]

All the functions and duties to be performed and all powers to be exercised by the bank or financial institution, other than those to be performed by the general meeting of bank or financial institution, shall be performed and exercised by the Board of Directors, subject to this Act, laws in force and memorandum of association and articles of association.

It shall be the duty of the board of directors to provide commitment with regard to no intervention in daily work and transactions of bank or financial institution in matters such as deposit collection, providing loan, making investment, employee management and making budget expenditure. It shall be the duty of the Board of Directors to operate bank or financial institution in the interest of depositors, customers and general public shareholders through overall risk management, by ensuring appropriate corporate governance in bank or financial institution. The other functions, duties and power of the board of directors shall be as follows:

- To formulate and implement necessary bye-laws, directives and procedures, in accordance with this Act, laws in force and directives of Rastra Bank, to perform the daily work of bank or financial institution properly,
- To formulate and implement internal control system and risk management standards in order to operate banking and financial transactions carefully as per policy and strategy and not to let arise risk or risky circumstances in banking or financial institution transactions,
- To make necessary policy level provisions for every actions and functions to be performed by bank or financial institution, regularly supervise the actions and functions performed and operate the bank or financial institution in well managed and prudent manner,
- To prepare clear organization hierarchy (grading) of bank or financial institution and to formulate policy and implement it,
- To present annual report along with auditor report in annual general meeting of bank or financial institution,
- To perform other functions as prescribed by the Rastra Bank from time to time.

Section 23 provides the responsibility and accountability of director shall be as follows:

- A director shall not do anything to derive personal benefit through the bank or financial institution or in the course of performing the functions of the bank or financial institution.
- A Director shall be personally liable for any act carried out exceeding his/her authority as of a Director of a bank or financial institution.
- A Director of a bank or financial institution shall assume responsibility with regard to the risks management and internal control by following sound business strategies of the institution.

- A Director shall not intervene in the day to day business and activities of the management of a bank or financial institution.
- A Director shall have to fully comply with the directives issued by the Rastra Bank from time to time

Details of Directors to be obtained by Bank or Financial Institution

Section 24 provides, bank or financial institutions shall obtain following details of a director:

- Name, caste, address, education qualification, occupation and experience of directors,
- If he or she is working as a director, officer or employee of any other entity, detail mentioning his or her position and responsibilities,
- Name and caste of family member of director or particulars of related person, or financial interest of his or her or of his or her family member in the bank or financial institution and other entity and share ownership of his or her or of his or her family member in such institutions,
- Particulars of shares or debentures in the bank or financial institution or in its holding or subsidiary company as subscribed by director or by his or her family,
- If any member of his or her family is working as an officer or employee of the bank or financial institution, details thereof,
- If he or she or any of his or her family members has entered into or going to entered into any kind of contract with the bank or financial institution, details thereof,
- If he or she has any kind of interest in the appointment of the chief executive, company secretary and auditor, details thereof,
- Written authority given to the Rastra Bank from director in regards of making examination or cause to make examination about his or her financial and business background or exchange such notice and information or cause to exchange such notice and information,
- Self-disclosure of being qualified to be a director pursuant to this Act,
- Such other details prescribed by the Rastra Bank from time to time.

The director shall submit the above particulars to bank or financial institution within 7 days from the date of his or her appointment. Bank or financial institution shall separately record the particulars submitted by the director. If the director or any member of his or her family has significant ownership directly or indirectly, or any other kind of interest, such director shall provide full detail about such information in the first meeting of Board of Directors. A director who has any kind of interest in the subject to be discussed at a board meeting or at any other sub-committee, he or she shall inform about his or her interest at the beginning of such meeting and shall not take part in the discussion or in voting related to such subject. If there is change in details submitted by a director or change in director, information thereof shall be submitted to the Rastra Bank within fifteen days.

Appointment and Terms and Conditions of Service of Chief Executive [Sec. 29]

The board of directors shall appoint a chief executive for management of bank or financial institution, subject to this Act, memorandum of association and articles of association. The

tenure of office of the chief executive shall be a maximum of 4 years and he or she may be re-appointed for one more term of office. The provision shall come into force after commencement of this Act.

The Act has provided powers to the board of directors to remove the chief executive from his or her post at any time if his or her work performance is not satisfactory. However, a reasonable opportunity shall be provided to submit his or her clarification before removing from him or her office. The Rastra Bank may remove the chief executive if he or she does not seem to be qualified as pursuant to this Act and give direction to concerned bank or financial institution for appointment of another person, who is qualified for appointment as chief executive pursuant to this Act.

A person having following qualification and experience shall be appointed as a chief executive and notice of such appointment shall be given to the Rastra Bank within 7 days from the date of such appointment:

- Having obtained master degree in management, banking, finance, monetary, economics, commerce, account, mathematics, business administration or law,
- Having obtained Chartered Accountancy degree or bachelor's degree in management, banking finance, monetary, economics, commerce, statistics, account, mathematics, business administration or law and have gained at least 10 years of work experience of the office of banking and financial sector, government entity, corporate body, university or international association or institution performing such work in the position of officer level or above. However, qualification and work experience for chief executive of class "D" financial institution, shall be as prescribed by the Rastra Bank.
- Having fulfilled the requirement as prescribed by Rastra Bank, related to the appointment of chief executive.
- Not being disqualified pursuant to sub-section (1) of section 18, other than clause (i) and (n) of sub-section (1) of the same section.

The remuneration and terms and conditions of service and other facilities of a Chief Executive shall be as specified by the Board of Directors and the terms and conditions of service and facilities shall be fixed at the time of his/her appointment.

The chief executive of any bank or financial institution shall not serve in the position of chief executive, officer, employee, or other position of any other business institution. However, if a bank or financial institution has made investment in infrastructure development bank, this sub-section shall not restrict him or her to become the director of such infrastructure development bank.

Section 30 provides, the Executive Chief shall be accountable to the Board of Directors for all of his or her functions. The functions, duties and powers of the chief executive shall be as follows:

- To exercise the power delegated by the Board of Directors, implement the decisions of the board of directors and supervise and control the activities and transactions of the bank or financial institution, subject to the memorandum of association and articles of association,
- To prepare annual budgets and action plans of the bank or financial institution and present them before the Board for approval,
- To manage necessary human resources, subject to the personnel bye-laws of the bank or financial institution,
- To implement, or cause to be implemented, the decisions of the general meeting,
- To operate the institution according to this Act and Rastra Bank's directives and ensure effective internal control and proper risk management of bank or financial institution,
- To present on time all such particulars, documents, decisions, etc. as are required to be submitted by the bank or financial institution to the Rastra Bank or any other body, subject to this Act, Rastra Bank's directives, memorandum of association and articles of association,
- To operate the institution ensuring maximum benefit of depositors, shareholders and bank or financial institution,
- To implement appropriate standards for top level management subject to the policy as determined by the board of directors.

4 PROVISION RELATING TO LICENSE

Bank or financial institution, being a public company shall require certificate to commence business from the Office of Company Registrar to conduct financial transactions. Prior to issue of certificate to commence business by the Office of Company Registrar, it shall require to obtain license to carry financial transactions from the regulator, i.e. Nepal Rastra Bank. Section 33(2) provides, a bank or financial institution desirous of carrying on banking or financial transactions pursuant to this Act shall make an application along with prescribed fee and following particulars and documents to the Rastra Bank for a license:

- A copy of the memorandum of association, articles of association of the bank or financial institution and the certificate of incorporation as per prevailing laws,
- Particulars of an office building equipped with all infrastructures required to carry on transactions, or, if such building is to be rented, a copy of lease agreement, and the particulars of the building rented along with particulars mentioning existence of adequate grounds for providing banking and financial services and facilities,
- Documents proving that the amount of shares which the promoter of the bank or financial institution has undertaken to subscribe has been paid and deposited with the Rastra Bank,
- Bye-laws relating to service, conditions and facilities of employees, financial administration bye-laws and bye-laws relating to write off of loans of the bank or financial institution,
- Address of main location or branch location for carrying on transactions, if confirmed,
- Consent given to comply with the conditions prescribed by the Rastra Bank for carrying on the banking and financial transactions,

- Business strategies and nature of transaction to be operated and a business plan prepared covering internal control and risk management process along with organizational structure of bank or financial institution,
- Name list of directors and officers and particulars mentioning that he or she is eligible to be a director or officer pursuant to this Act,
- Commitment that the minimum capital as prescribed by the Rastra Bank from time to time shall be maintained until the banking or financial transaction is carried on,
- Commitment that the bank or financial institution can maintain the internal control process to manage all the possible risks in an appropriate way,
- Such other particulars and documents as may be prescribed by the Rastra Bank from time to time.

In the case of a bank or financial institution to be established in Nepal under the joint venture of any foreign bank or financial institution, following documents or particulars shall be submitted to the Rastra Bank in addition to the particulars mentioned in sub-section (2):

- In case of 'A', 'B', 'C' and 'D' class of bank or financial institution, approval or consent letter obtained, as per laws of respective nation, by the foreign bank or financial institution from government of such nation or central bank or regulatory entity that authorizes to carry on banking and financial transaction to such foreign bank or financial institution in Nepal,
- In case any difference has aroused during fulfillment of any matters as per this Act, after submitting application to the Rastra Bank for incorporation of foreign bank or financial institution or after obtaining approval from the Rastra Bank, than such foreign bank or financial institution shall provide details thereof,
- Other information and documents as demanded by the Rastra Bank.

The Rastra Bank shall ascertain the following matters on receipt of the application for license submitted by a bank or financial institution:

- If the issuance of the license to carry on banking or financial transactions shall ensure a healthy competition and make effective the transactions relating to financial intermediation and thus serve the interests of depositors,
- If the bank or financial institution is competent to carry on financial transactions, subject to this Act or the rules or byelaws framed under this act or the given orders or directives and the memorandum of association and articles of association,
- If, based on the application and the particulars and documents attached with the application made for the license are complete and has adequate physical infrastructure,
- If any of the officer appointed or involved or to be appointed or to be involved in bank or financial institution is capable to operate banking and financial transactions.

If Rastra Bank finds all the requirement for carrying on banking or financial transaction is fulfilled, it may issue a license of any one of the classes to carry on banking or financial transactions, on the basis of the classification of banks or financial institutions as referred to in section 37 within 120 days.

In cases where the Rastra Bank has specified the date of commencement of a license while issuing a license to carry out banking and financial transactions, the license shall be deemed to have been commenced from that specified date. If no such date has been specified, the license shall be deemed to have been commenced from the date of the issuance of the license.

Power of Nepal Rastra Bank to Refuse to Issue License

The Rastra Bank may refuse to issue a license to any bank or financial institution to carry on the banking and financial transactions in any of the following circumstances:

- If it causes adverse effects on the stability, fair competition and credibility of the financial system of Nepal,
- If it is not reasonable and appropriate to issue a license for operation of financial transactions for the protection of the interests of depositors,
- If the infrastructure to operate banking and financial transactions are not completed,
- If other particulars or conditions set forth in this Act are not found to be fulfilled.

If there exists a situation where the license to carry on the banking and financial transactions cannot be issued to any bank or financial institution pursuant to this section, the Rastra Bank shall give a notice thereof accompanied by the reason for the same, to the concerned bank or financial institution within 90 days from the date of application.

Classification of Bank or Financial Institutions

The Rastra Bank shall classify banks or financial institutions in to classes “A”, “B”, “C” and “D” based on the minimum paid up capital of a bank or financial institution, transaction to be operated on by such a bank or financial institution and working areas, and issue a license to the concerned bank or financial institutions accordingly. However, an infrastructure development bank shall not be included in any class.

Class "B", class "C" and class "D" financial institution shall use the name as Development bank, Finance company and Micro finance financial institution respectively. The licensed institution using the name micro-finance development bank before commencement of this Act, shall use the name Micro finance financial institution after the commencement of this Act.

Conversion into Bank or Financial Institution of Higher Class [Sec. 38]

If any financial institution of a lower class wishes to convert into bank or financial institution of one level higher class, it shall be required to make an application to the Rastra Bank along with particulars prescribed by the Rastra bank. However, there is no provision of conversion of class "D" institution into higher class.

While making an examination of the application and particulars attached therewith, the Rastra bank if finds appropriate to convert into bank or financial institution of one level higher class, may give prior approval to such bank or financial institutions subject to the following terms and conditions:

- If it has paid up capital as prescribed by the Rastra Bank for a bank or financial institution of such higher class,
- If it has maintained the capital adequacy fund as directed by the Rastra bank since last five years, has earned profits since last five consecutive years and has its average non-performing loan of last five years within the limit prescribed by the Rastra Bank,
- If it has written off the preliminary expenses,
- If the shares required to be issued publicly are issued and allotted,
- If the general meeting has passed the special resolution of conversion into bank or financial institution of higher class,
- If it has met all the conditions as prescribed by the Rastra Bank.

Rastra Bank shall require the bank or financial institution that has received the prior approval as above, to amend the memorandum of association and articles of association pursuant to the prevailing laws and issue the license of bank or financial institution of higher class.

Provision Relating to Operation of Financial Institution in Provinces

The amendment in the Act has introduced new section 39A on provision relating to operation of financial institution in provinces. It provides financial institutions may be operated at Province Level within the limit, conditions or directives specified by Nepal Rastra Bank. Such Financial Institutions shall obtain license according to the law framed by Province within the licensing policy determined by Nepal Rastra Bank. The regulation, inspection and supervision of Financial Institutions operated pursuant to this section shall be conducted by Nepal Rastra Bank. Other provisions relating to operation of Financial Institutions at Province Level shall be according to the law of concerned Province within the ambit of this Act.

5 CAPITAL, CAPITAL FUND AND LIQUID ASSETS

Capital of Bank or Financial Institution

Section 41 provides, the minimum paid-up capital of the bank or financial institution shall be as prescribed by the Rastra Bank from time to time and such capital shall be maintained by the bank or financial institution within the time frame as set by the Rastra Bank.

Nepal Rastra Bank has laid down the following minimum capital requirements for a bank or financial institution through the Monetary Policy 2072/73:

Category of Bank or Financial Institution	Paid up capital (Rs. in million)
Commercial	8,000
Development Banks (National level)	2,500
Development Banks (Provincial Level)	1,200
Finance Companies (National level)	800
Finance Companies (Provincial Level)	500

The Rastra Bank may make provision that any person, firm, company or institution can invest only up to 15 % of paid up capital of any one bank or financial institution. A person, firm,

company or institution making an investment in any one bank or financial institution as such, may make an investment of less than 1 % of paid up capital of other bank or financial institution.

Provisions concerning investment by any person, firm, company or institution in the paid up capital of any bank or financial institution to be established in foreign joint venture, a "D" class financial institution and infrastructure development bank shall be as prescribed by the Rastra Bank. The percentage of the share capital that may be invested by any person or institution in order to incorporate a bank or financial institution or invest in a bank or financial institution shall be as prescribed by the Rastra Bank from time to time

Capital Fund [Sec. 42]

A bank or financial institution shall maintain a capital fund in the ratio prescribed by the Rastra Bank on the basis of its total assets or total risk-weighted assets. While prescribing such ratio, the Rastra Bank may also prescribe additional capital fund ratio.

"Capital Fund" means the total of primary and supplementary capital of a bank or financial institution as prescribed by Rastra Bank and this term includes any other fund of the institution as prescribed as such by the Rastra Bank from time to time.

"Primary capital" means the funds of a bank or financial institution listed under such headings as the paid-up capital, share premium, non-redeemable preference shares, general reserve fund and accumulated profit and loss, and this term also includes such other funds listed under other headings as may be prescribed as primary capital by the Rastra Bank from time to time.

"Risk-weighted Assets" means the total assets calculated by multiplying the amounts coming under each heading of on-balance sheet and off-balance sheet operations of a bank or financial institution by the risk-weight prescribed by the Rastra Bank.

If any bank or financial institution fails to maintain the capital fund as referred above, the Board of Directors of such bank or financial institution shall give information thereof to the Rastra Bank within one month. In addition to the other matters, the information shall also be accompanied by the reasons for failure to maintain the capital fund and the plan or program prepared by the Board of Directors to increase the capital fund and restore it to the position as prescribed by the Rastra Bank.

If the information and plans or program submitted by the Board of Directors seems to be reasonable, the Rastra Bank may give necessary directives to the concerned bank or financial institution to implement such plan or program, and if any amendment or alteration is to be made in the proposed plan or program, it may give directive, accompanied by the reason for such amendment or alteration to the concerned bank or financial institution to amend or alter such plan or program and implement the same.

Provision Related to Possible Losses [Sec. 43]

A bank or financial institution shall make provisions of possible loss as prescribed by the Rastra Bank so as to be able to cover its potential risks concerning assets including loans and liabilities incurring from the off balance sheet transactions. "Off-Balance Sheet Transactions" means transactions relating to letters of credit, letters of guarantee, letters of acceptance, commitments, swaps, options and forward exchange transactions for which a bank or financial institution may be required to bear liability and this term also includes transaction of instruments as specified by Rastra Bank from time to time.

General Reserve Fund

Section 44 provides requirement of a bank or financial institution to maintain a general reserve fund. At least 20 % of the net profits of each fiscal year shall be credited to such fund until the amount of such fund becomes double of the paid up capital and thereafter, at least 10 % of net profits of each fiscal year shall be credited to such fund. The amount credited to the reserve fund may not be spent or transferred to any other headings without prior approval of Nepal Rastra Bank.

Exchange Equalization Fund [Sec. 45]

A bank or financial institution which has obtained the license to carry on foreign exchange transactions shall make necessary accounts adjustments in the profit and loss account of the revaluation profits earned as a result of fluctuations in exchange rates of foreign currencies, other than Indian currency, every year at the end of the same fiscal year. While making such accounts adjustment in the profit and loss account, if revaluation earning has been made in any fiscal year, at least 25 % of such profits shall be credited to the exchange equalization fund. However, in the case of revaluation profit-loss resulting from fluctuation in the exchange rate of the Indian currency, it shall be as prescribed by the Rastra Bank.

The amount credited to the exchange equalization fund shall not be spent or transferred for any purpose other than the adjustment of loss resulting from the fluctuation of foreign currencies without approval of the Rastra Bank.

Liquid Assets [Sec. 46]

A bank or financial institution shall maintain the liquid assets as prescribed by the Rastra Bank from time to time. Liquid assets means the cash balance of a bank or financial institution, the balances held in current account, the balance maintained in the Rastra Bank and such assets of a bank or financial institution prescribed as liquid assets by the Rastra Bank from time to time.

Declaration and Distribution of Dividend

Section 47 provides, a bank or financial institution shall obtain approval of the Rastra Bank before declaring and distributing dividends. It shall not be allowed to declare or distribute dividends to its shareholders until it recovers all of its preliminary expenses and the losses sustained by it until the previous year has been set off, capital as prescribed by the Rastra Bank has been maintained, sets aside such amount as required to be set aside for capital fund,

provision for possible losses and for general reserve fund pursuant to Section 44 and until complete sale of shares to be allotted to the general public.

6 OPERATION OF BANKING AND FINANCIAL TRANSACTIONS

The Rastra Bank shall classify banks or financial institutions in to classes “A”, “B”, “C” and “D” based on the minimum paid up capital of a bank or financial institution, transaction to be operated by such a bank or financial institution and working areas, and issue a license to the concerned bank or financial institutions accordingly. However, an infrastructure development bank shall not be included in any class.

Class "B", class "C" and class "D" financial institution shall use the name as Development bank, Finance company and Micro finance financial institution respectively. The Act has specifically prescribed the transactions to be carried by the bank or financial institutions depending on the classifications.

Section 49(1) provides, subject to this Act, memorandum of association and articles of association and limit, conditions or directions prescribed by the Rastra Bank, a Class "A" bank may carry following banking and financial transactions:

(a) Accepting deposits with or without interest or mobilizing the deposits through various means of financial instruments and refund of such deposits,
(b) Accepting deposits, making payments, dealing, acting as mediator and transfer funds through electronics instruments or means,
(c) Supplying credits including hire-purchase, leasing, housing and overdraft,
(d) Supplying credits by mortgaging projects and taking hypothecation and make arrangements for jointly supplying credits on the basis of co-financing in accordance with the mutual agreement entered into for the division of the collateral (paripassu),
(e) Supplying credit against the guarantee provided by any foreign bank or financial institution,
(f) Supplying a fresh credit against the security of the same movable or immovable assets which have been furnished with it or with any other bank or financial institution as security, to the extent covered by the total value of such security,
(g) Issuing guarantees on behalf of its customers, having such customers execute necessary bonds in consideration thereof, and acquire their movable or immovable assets as collateral or on mortgage, or the assets of third persons as collateral and to acquire the obtained security and mortgaged property, use it and do other transactions related with it,
(h) Obtaining refinance credit from the Rastra Bank as per necessity, or obtaining or supplying credits to or from other bank or financial institutions,
(i) Supplying funds received from the Government of Nepal or other native or foreign agencies as credits for the promotion of projects, or managing such credits,
(j) Writing off credits, subject to the prevailing credit write-off bye-laws,
(k) Issuance of share, debenture, bonds, etc. for the purpose of meeting capital fund.

(l) Issuing, accepting, paying, discounting or purchasing and selling letters of credit, bills of exchange, promissory notes, cheques, travelers cheques, drafts or other financial instruments,
(m) Issuing, accepting and managing digital or cards and other financial instruments, as well, for carrying on electronic transactions and appointing agents to discharge functions related there to,
(n) Carrying on foreign exchange transactions, subject to prevailing laws,
(o) Carrying on governmental transactions, subject to limit, conditions or directives prescribed by the Rastra Bank,
(p) Purchasing, selling or accepting bonds issued by the Government of Nepal or Rastra Bank,
(q) Remitting or transmitting funds to different places within or outside Nepal through cheques or other financial instruments, receiving remittance from foreign countries and making payment of such remittance,
(r) Acting as a commission agent of its customers, taking custody of and arranging for the sale or purchase of shares, debentures or securities, collecting interest, dividends, etc. accruing from shares, debentures or securities, remitting or transmitting such interests or dividends to places within or outside Nepal, making arrangements of safe deposit vaults for customers,
(s) Carrying on off-balance sheet transactions,
(t) Supplying credits not exceeding the amount prescribed by the Rastra Bank, against individual or collective guarantee, for the economic up-liftment of the destitute (poor) class, low-income families, victims of natural calamities and inhabitants (residents) in any area of the country,
(u) Exchanging with the Rastra Bank, concerned entity or any other bank or financial institutions particulars of, information or notices on debtors or customers who have obtained credits or any types of facilities from it or other bank or financial institutions,
(v) Purchase-sale of gold, silver,
(w) Doing, or causing to be done, study, research and survey work relating to the establishment, operation and evaluation of projects, and providing training, consultancy and other information,
(x) Properly managing or selling all types of assets coming under its ownership, pursuant to this Act and prevailing laws,
(y) Providing guarantee, on consent of two parties, for receiving or making payments arrangements between two or more than two parties for the work that has been done and amount has to be paid, payable or receivable after completion of such work, pursuant to prevailing laws,
(z) Performing such other functions as may be prescribed by the Rastra Bank.

Section 49(2) provides, subject to this Act, the memorandum of association and articles of association and limit, conditions or directives prescribed by the Rastra Bank, a class "B" financial institution may carry following other banking and financial transactions in addition to

the banking and financial transactions mentioned in clause (a), (b), (c), (f), (h), (i), (j), (k), (n), (p), (r), (s), (t), (u) and (x) of sub-section (1):

(a) Supplying credits by mortgaging projects, making arrangements for jointly supplying credits on the basis of co-financing in accordance with the mutual agreement entered into for the division of the collateral (paripassu),
(b) Issuing guarantees on behalf of its customers, having such customers execute necessary bonds in consideration thereof, and acquire their movable or immovable assets as collateral or on mortgage, or the assets of third persons as collateral,
(c) Issuing, accepting, paying, discounting or purchasing and selling bills of exchange, promissory notes, cheques, travelers cheques, drafts,
(d) Obtaining credit against the security of its movable and immovable property,
(e) Dealing in Letter of Credit and remittance transactions, by taking prior approval from the Rastra Bank,
(f) Acting as a commission agent of its customers, taking custody of and arranging for the sale or purchase of shares, debentures or securities, collecting interest, dividends, etc. accruing from shares, debentures or securities, collecting such interests, profits, dividends, making arrangements of safe deposit vaults for customers,
(g) Activities relating to transmitting funds within Nepal,
(h) Doing, or causing to be done, study, research and survey work relating to the establishment, operation and banking, accounting, assets, loan evaluation of projects, and providing training, consultancy, and other services and information,
(i) Performing such other functions as may be prescribed by the Rastra Bank.

Section 49(3) provides, subject to this Act, the memorandum of association and articles of association and limit, conditions or directives prescribed by the Rastra Bank, a class "C" financial institution may carry following other banking and financial transactions in addition to the banking and financial transactions mentioned in clause (a), (b), (f), (h), (j), (k), (p), (r), (t), (u) and (x) of sub-section (1):

(a) Supplying credits including hire-purchase, leasing, housing loans,
(b) Supplying credits jointly, on the basis of co-financing in collaboration with other bank or financial institutions in accordance with the mutual agreement entered into for the division of the collateral *(paripassu)*,
(c) Obtaining credit against the security of its movable and immovable property,
(d) Making proper arrangements of its assets, sell or rent the same,
(e) Issuing, accepting, paying, discounting or purchasing and selling bills of exchange, promissory notes, cheques, travelers cheques, drafts or other financial instruments,
(f) Dealing in foreign currencies transactions by getting approval from the Rastra Bank,
(g) Supplying installment or hire purchase credit to any person, firm, company or institution for acquiring a motor vehicle, machine, tools, equipment, durable household goods or similar movable property,

(h) Supplying credit to any person, firm, company or institution for hiring a motor vehicle, machine, tools, equipment, durable household goods or similar movable property, or renting such movable property,
(i) Issuing guarantees on behalf of its customers, having such customers execute necessary bonds in consideration thereof, take securities, acquire their movable or immovable assets on mortgage, or take the assets of third persons as collateral,
(j) Leasing or selling any part of its assets, or as a whole,
(k) Determining the value of goods on consent of seller and financial institution, if any purchased goods need to be sold to another buyer on immediate or on deferred payment terms,
(l) Performing such other functions as may be prescribed by the Rastra Bank.

Section 49(4) provides, subject to this Act, the memorandum of association and articles of association and limit, conditions or directives prescribed by the Rastra Bank, a class "D" financial institution may carry following banking and financial transactions:
(a) Supplying micro-credit, with or without any movable or immovable property as the collateral or security, for operating micro-enterprises to the projects prescribed by the Rastra Bank or any group or members thereof who have regularly saved,
(b) Obtaining credit or grants from bank or financial institution or native or foreign organization, and use such credits or grants for the supply of micro-credit or for making the same effective, Provided that approval of the Rastra Bank shall be obtained prior to obtaining credits or grants from any foreign organization.
(c) Prior to supplying micro-credits, evaluating the schemes for which micro-credits have been requested and determining whether they are feasible,
(d) Providing necessary services and consultancy to a group in respects of mobilization of micro-credit,
(e) Taking necessary action towards the timely realization of micro-credits,
(f) Subject to conditions and limitations prescribed by the Rastra Bank, accepting deposits and refund such deposits, after obtaining approval from the Rastra Bank,
(g) Issuing share, debenture, bonds, etc. for the purpose of meeting the capital fund requirement,
(h) Exchanging with the Rastra Bank, concerned entity or any other bank or financial institutions particulars of, information or notices on debtors or customers who have obtained credits or any types of facilities from it or any other bank or financial institutions,
(i) Performing such other functions as may be prescribed by the Rastra Bank.

Section 49(5) provides, subject to this Act, the memorandum of association and articles of association and limit, conditions or directives prescribed by the Rastra Bank, an infrastructure development bank may carry following financial transactions:
(a) Supplying credit in projects related to infrastructure development and investing in shares thereof,
(b) Investing in securities of company operating projects related to infrastructure development,

(c) Issuance of bonds and opening letter of credit for transactions related to purchase, sales or import or installation of necessary machinery equipment and their parts, for operation and development of projects related to infrastructure development,
(d) Acceptance of credit and issuance of various kinds of financial instruments in native or foreign currencies for arranging necessary funds for investment in projects related to infrastructure development, on approval from the Rastra Bank,
(e) Acceptance of deposits of long term nature or issuance of debentures, and mobilization of source thereof,
(f) Dealing in leasing transaction by obtaining approval from the Rastra Bank,
(g) Providing of credit and facilities in projects by accepting guarantee of foreign bank or financial institutions,
(h) Performing such other functions as may be prescribed by the Rastra Bank.

Activities Prohibited for Being Carried out by Bank or Financial Institutions

Section 50 (1) has restricted the following activities to be carried out or cause to be carried out by a bank or financial institution:

(a) Purchasing or selling goods for commercial purpose, constructing building or purchasing any immovable property except when it is required for its own use,
(b) Advancing credit against the security of its own shares,
(c) Supplying any kind of credit or facilities to any directors, persons who have subscribed 1 % or more of its shares, chief executive or any family member of such persons or managing agent or person, firm, company having authority to appoint director, or institutions having significant ownership or any firm, company or institution having financial interest,
(d) Supplying credit or facility in an amount exceeding per customer limit of its capital fund as prescribed by the Rastra Bank to a single customer, company and companies or partnership firm of a single group, associate person,
(e) Supplying any type of credit to any person, firm, company or institution against the guarantee given by the promoters, directors or chief executive,
(f) Making investment in securities of a bank or financial institutions which is classified as class "A", "B" and "C" by the Rastra Bank,
(g) Making investment of an amount exceeding the limit prescribed by the Rastra Bank in the share capital of any other institution,
(h) Indulging with other bank or financial institutions to mutually create any type of monopoly (cartel) or any other type of controlled practice in the financial transactions,
(i) Doing any kind of act which is capable of creating an artificial obstruction in the competitive environment of the financial sector, with the intention of deriving undue (unjustified) advantage,
(j) Doing such other acts prohibited from being done by a bank or financial institution as may be prescribed by the Rastra Bank.

Sub-section (2) provides notwithstanding anything mentioned in this Act, nothing shall deemed to prevent a bank or financial institution for carrying on its banking and financial transactions or providing accommodation or other facilities to its employees pursuant to prevailing employee bye-laws of bank or financial institution, supplying credit against bonds issued by the Government of Nepal or the Rastra Bank, providing credit against collateral of fixed deposit receipt or against amount available in any kind of saving account and providing of credit to promoter, director, chief executive or shareholders subscribing more than 1 % of share against collateral of their own fixed deposit, against bonds issued by the government of Nepal or Rastra Bank, or providing credit card facility within the prescribed limit.

7 SUPPLY AND RECOVERY OF CREDIT

Supply of Credits

Section 55 provides, a bank or financial institution shall supply credit only after disclosing the purpose of such credit, subject to the directives of the Rastra Bank and the credit policy determined by the Board of Directors. While supplying credit, a bank or financial institution shall obtain any movable or immovable property acceptable to it as a security or an appropriate guarantee in a manner to safeguard its and depositors interest.

A bank or financial institution shall write to the concerned office to so withhold property which it has been taken up as the security against a credit pursuant to this section that such property cannot be registered in the name of or transferred to any person or transmission thereof and shall be registered or transmission or withhold in the name of bank or financial institution. When requested to registration or transmission or withhold the property, the concerned office shall do registration or transmission or withhold pursuant to the request.

The Rastra Bank may give directive to disburse credits for such class and in such area as prioritized for the economic up-liftment of the persons belonging to a low-income and indigent (poor) class and of the inhabitants (people) residing in any specific geographical region. The bank or financial institution shall disburse credit according to the prescribed directive.

The matters related to the conditions, installment and interest of the credit borrowed by the borrower from bank or financial institution shall be as per the conditions, installment and interest mentioned in the deed or contract signed related to the credit transaction. While supplying credit, the bank or financial institution shall clearly disclose the loan amount provided to borrower, interest rates, penalties applicable and repayment schedule in the loan deed or contract and provide such information to the borrower or guarantor if any.

The borrower may request for the particulars of principal, interest, penalties and other fees paid or due payable in respect of credit and also the deed or contract related document which has been taken while providing credit. It shall be the duty of the bank or financial institution to provide such particulars to the borrower.

Recovery of Credit

Section 57 provides, if the borrower fails to abide by the mentioned terms of concerned deed or contract of credit transactions or fails to pay credit or interest thereon or penalties within the time-limit stipulated in deed or contract, or if the licensed institution finds through monitoring pursuant to section 56 that the borrower has not used the credit amount for the purpose for which it has been supplied or misused it, the bank or financial institution may, notwithstanding anything mentioned in the concerned deed or in the laws in force of credit transactions, recover its principal and interest by auctioning or otherwise disposing of any property pledged to it, or any collateral or security deposited with it, by the borrower.

Notwithstanding anything mentioned in the prevailing laws, if a borrower relinquishes (hand over) in any manner the title of the property registered or pledged to the bank or financial institution, or if the value of such collateral or security declines for any other reason, the bank or financial institution may ask the borrower to furnish additional collateral or security within a period prescribed by it. The borrower shall furnish the additional collateral or security within the time-limit prescribed by the bank or financial institution. If the borrower fails to furnish the additional collateral or the principal and interest cannot be recovered from the collateral or security, the bank or financial institution may recover its principal or interest from any other movable and immovable property owned by the borrower or to which the borrower has title in accordance with the prevailing laws in force. The amount of principal, interest and penalties due to the bank or financial institution and the expenses incurred in collecting proceeds from auction or other disposal of a property made pursuant to this section shall be deducted, and the balance if any, shall be refunded to the concerned borrower.

The bank or financial institution shall write to the concerned office for registration or transmission of the assets auctioned or sold pursuant to this section in the name of the person who has taken over it.
When so requested for registration or transmission of the assets, the concerned office shall make registration or transmission in the name of such person who has taken over it.

If no one offers a bid in an auction sale under this section of the movable and immovable property pledged as the collateral or security, the bank or financial institution may take over the ownership of such property as prescribed. The bank or financial institution shall write to the concerned office for registration or transmission of the property of which ownership has been taken over by such institution in its name. When so requested, the concerned office shall make registration or transmission of such property in the name of bank or financial institution.

If the previous owner of the property, taken over by a bank or financial institution or any person in an auction, refuses or creates obstruction to allow its possession and use, the appropriate body of the Government of Nepal shall arrange for possession and use according to the prevailing laws.

If borrower has failed to repay the credit borrowed from a bank or financial institution and interest thereon and penalties within the repayment period of the credit deed or contract related

to credit transaction, the bank or financial institution shall write to the Credit Information Center Limited to include such borrower in the black list in accordance with the laws in force.

If a credit cannot be recovered even while taking action for the recovery of such credit against any borrower pursuant to this section, the bank or financial institution concerned may institute action for recovery of credit including the withholding of property of the borrower situated abroad in accordance with the laws in force.

If a credit cannot be recovered even upon taking all actions on recovery of credit pursuant to this section, the bank or financial institution may make a request to the Rastra Bank for necessary provision to withhold and seize the passport of the borrower and to deprive such borrower from any facilities to be provided by the State. On receipt of such request, the Rastra Bank shall forward the matter, accompanied by its opinion, to the Government of Nepal for necessary action.

8 ACCOUNTS, RECORDS, RETURNS AND REPORTS

A bank or financial institution shall maintain its accounts, ledgers, records, and books of accounts accuratelyand in an up to date manner. The accounts shall have to be maintained according to recognized principles of the double entry book keeping system reflecting the exact status of transactions of the bank or financial institution. Except as otherwise approved by the Rastra Bank, the accounts and other particulars to be maintained by the bank or financial institution shall be kept at its registered office.

A licensed branch or office of a foreign bank or financial institution shall prepare and maintain financial statements including separate accounts, books and records of its assets, liabilities, income and expenses and profit and loss accounts.

Preparation of Balance Sheet and Profit and Loss Account [Sec. 59]

Banks or financial institutions shall prepare and maintain its balance-sheet, profit and loss account and cash flow statement and other statements in such format and in such manner as prescribed by the Rastra Bank.

Banks or financial institutions shall submit their balance sheet and profit and loss account to the Rastra Bank within three months of the completion of each fiscal year and details of such balance sheet and profit and loss account shall be made public for information of the general public as prescribed by the Rastra Bank within that period. Banks or financial institutions shall make public the audited balance sheet and profit and loss accounts of the transactions of each fiscal year within and outside Nepal in such formats as prescribed within nine months of the next fiscal year.

If a bank or financial institution has a subsidiary company, the balance-sheet and profit and loss accounts and status of the transactions of business of the subsidiary company and parent company shall be maintained separately as well as in an integrated manner.

The format, contents, methods of certification and details of the matters to be made public in the balance sheet and profit and loss accounts to be prepared by a bank or financial institutions shall be as prescribed or directed by the Rastra Bank.

Audit Committee [Sec. 60]

Section 60 of the Act has introduced provisions relating to Audit Committee for the first time. The Board of Directors of a bank or financial institution shall form an audit committee under theconvenorship of non-executive director and consisting of three members. The chairman of bank or financial institution, coordinator of sub-committee and executive chief shall not work in the audit committee. The member of audit committee shall not be entitled to be engaged in accepting deposit, supplying credit, making investment in securities, taking decision of spending approved budget including day-to-day transactions. The meeting of audit committee shall be held once in every three months, except in the situation where the meeting is called by the Board of Directors. The working procedure regarding the meetings of audit committee shall be as determined by the committee itself.

The functions duties and powers of the Audit Committee shall be as follows:

- To monitor and supervise whether or not account, budget and internal audit procedure, internal control system of bank or financial institution is appropriate and if appropriate, whether or not it is implemented.
- To cause to conduct internal audit of account and books of BFI and to confirm whether or not such documents are prepared accurately as per prevailing laws, regulation and directives of the Rastra Bank.
- To examine or caused to be examine the management and functioning of regular management and work performance of bank or financial institution so as get assured that the prevailing laws has been fully implemented in bank or financial institution.
- To monitor whether or not the functions and activities carried on by bank or financial institution is as per this Act or rules formed under this Act, byelaws, rules or given directives and submit a report to the Board of Directors on this matter.
- To recommend the names of three auditors for appointment of external auditor.
- To suggest on matters as demanded by the Board of Directors.

Audit and Appointment of Auditor

A bank or financial institution shall prepare its balance sheet, profit and loss account, cash flow statement and other financial statements as well, in such format and in accordance with such methods as specified by the Rastra Bank and have them audited within four months after the expiry of the fiscal year. Such financial statement shall be signed by at least two directors, chief executive and the auditor. However, in the case of a branch office of a foreign bank or financial institution carrying out financial transactions with the approval from the Rastra Bank, it shall be as prescribed by the Rastra Bank. If any bank or financial institution fails to have its account audited within this period, makes a request accompanied by a reasonable reason, for an extension of the period for audit, the Rastra Bank may extend a period of not more than two months.The external auditor shall submit a report of audit performed by him or her to the concerned bank or financial institution and the Rastra Bank.

Section 63 provides, the General Meeting of a bank or financial institution shall appoint an auditor. The Rastra Bank may appoint auditor if the general meeting of the bank or financial institution did not or could not appoint the auditor. The general meeting shall not appoint the same auditor for more than three consecutive terms. In case the post of auditor remains vacant due to any reason, the Board of Director shall appoint another auditor for remaining period.

The General Meeting shall appoint a Chartered Accountant (CA) in the case of a bank or financial institution of Class "A", "B" and "C", and a CA or a Registered Auditor (RA) in the case of a bank or financial institution of Class "D".

The remuneration of the auditor shall be as prescribed by the Rastra Bank if he or she is appointed by the Rastra Bank, by the general meeting if he or she is appointed by the general meeting and by the Board of Directors if he or she is appointed by the Board of Directors.

Disqualification for Appointment as Auditor [Sec. 64]

Any of the following persons or any firm or company or institution in which such person is promoter or partner shall not be eligible to be appointed as an auditor of a bank or financial institution:

- A promoter, director, chief executive of a bank or financial institution or his or her family member,
- An officer, employee or internal auditor of a bank or financial institution,
- A person working as a partner of director, chief executive or employee of bank or financial institution,
- A borrower, a person having significant ownership or associate person of the bank or financial institution or a person having financial interest,
- A person who is insolvent in Nepal or in foreign,
- A person, firm, company or institution having subscribed one percent or more of the shares of concerned bank or financial institution,
- A person who has been punished by the court for a criminal offense and a period of five years has not lapsed after he or she has served the punishment,
- A person who is not eligible to be appointed as an auditor as per prevailing laws.

Functions, Duties and Powers of Auditor

Section 66 has prescribed the following functions, duties and powers of an auditor:

- To conduct audit of accounts and financial statements,
- To prepare and submit the audit report including the account, balance sheet and profit and loss account audited by him or her to the Board of Directors of bank or financial institution,
- To inform the Board of Directors in matters where there is irregularities in functions and activities of bank or financial institution or the functions has not been carried out appropriately and such matters that could result in loss to the bank or financial institution,
- To inform the Rastra Bank if there is probability of occurrence of following situations:
  - If there is violation of the conditions prescribed by the Rastra Bank, while giving license to bank or financial institution, or violation of this Act or rules, bye-laws framed under this Act or directives issued by Nepal Rastra Bank,

- If there arises adverse effect in daily functions and activities of bank or financial institution,
- If auditor is prevented from issuance of the audit report or is forced to submit incorrect audit report.

The auditor has authority to examine at all times the account, books, records, vouchers including every documents and data of bank or financial institution while fulfilling his or her duties. The auditor can demand the necessary information and explanation from the officer of bank or financial institution required while executing his or her work in appropriate manner and fulfilling his or her duties.

The auditor shall clearly mention the following matters in his or her report:

- Whether or not replies to the queries asked by him or her were given,
- Whether or not the balance sheet, off-balance sheet transactions, profit and loss account, cash flow statement and other financial statements, as well, have been prepared in such format and in accordance with such procedure as prescribed by the Rastra Bank, and whether or not they correspond to the accounts, records, books and ledgers maintained by the bank or financial institution,
- Whether or not the accounts, records, books and ledgers have been maintained accurately in accordance with the laws in force,
- Whether or not any officer of the BFI has done any act contrary to the laws in force or committed any irregularity or caused any loss or damage to the licensed institution,
- Whether or not credit has been written off as prescribed by credit write-off bye-laws or prescribed by the directives of the Rastra Bank,
- Whether or not the transaction of bank or financial institutions have been carried on in a satisfactory manner, as prescribed by the Rastra Bank,
- Matters, which, should be made known to the shareholders,
- Such matters prescribed by the laws in force and other matters prescribed by the Rastra Bank as required to be mentioned by an auditor in his or her report,
- Other suggestions which the auditor deems necessary to be furnished.

The Rastra Bank may, upon receipt of the audit report, if it deems necessary, order the auditor of the bank or financial institution to carry out the following additional functions:

- To submit additional information, that the Rastra Bank thinks is necessary in regards to auditing,
- To enhance the areas of auditing of transactions of bank or financial institution or its subsidiary company,
- To conduct other examination on any specific matters prescribed by the Rastra Bank or as recommended by the bank or financial institution.

Recommendations for Taking Actions against Auditor [Sec. 67]

The Rastra Bank shall recommend to the concerned regulating authority to remove the name of an auditor, who does not perform his/her duties as set forth in this Act, from the panel of the auditors prohibiting him/her to carry out audit of any bank or financial institution for one year to

three years. In cases where such recommendation has been received, the concerned regulating agency shall take actions against such an auditor under the prevailing laws.

9 MERGER AND ACQUISITION OF BANKS OR FINANCIAL INSTITUTIONS

The term 'merger' is an agreement that unites two existing bank or financial institution into one bank or financial institution. "Acquisition" means the process of acquiring a licensed institution by another licensed institution on account of total assets and contingent liabilities resulting in the end of legal status of the acquired licensed institution and this term also includes the acceptance of contractual agreement entered by targeted institution before merger with acquirer institution.

A bank or financial institution may be merged with another bank or financial institution or a bank or financial institution may acquire another bank or financial institution by fulfilling the procedures prescribed by this Act and the Nepal Rastra Bank Act. A class "D" financial institution may be merged with or such institution may acquire another institution of the same class. The Act prohibits an infrastructure development bank and a bank or financial institution to be merged into each other and to acquire each other.

Notwithstanding anything contained elsewhere in this Chapter, in case any of the following circumstances is found from an inspection and supervision report of the Rastra Bank, it may order by giving the reason thereof, such bank or financial institution or any of its assets, liabilities, or business to merge or be merged into another bank or financial institution:

- Capital fund is inadequate or financial position has been deteriorating for last three years,
- An act causing adverse effect on depositor's interests and liabilities towards depositors or such situation is prevailing,
- It is necessary to enhance the competitive capacity at national and international level for stability, development and promotion of the financial system.

Notwithstanding anything contained elsewhere in this Chapter, in case any of the following circumstances is found from an Inspection and Supervision Report of the Rastra Bank, it may order by giving the reason thereof, such bank or financial institution to acquire or cause to be acquired another bank or financial institution:

- In case more than one bank or financial institution belonging to single group of persons, firms and companies are in operation and there is unhealthy financial relation,
- In case rights and interests of the depositors, ordinary shareholders, and other customers could not be protected due to the negative impact, if the bank or financial institution is operated in the status quo,
- System-based risks are increased and the licensed institution is unable to pay its liabilities,
- In case shares have not been issued in the ordinary group within the prescribed time, the issued shares have not been sold or subscribed, or the prescribed minimum proportional paid up capital has not been met,
- In case a bank or financial institution is subjected to actions of rapid reforms for 3 times or more or good governance has become weak due to frequent disputes in the Board of Directors of the bank or financial institution.

Submission of Application for Merger or Acquisition

Section 70 provides, in case any bank or financial institution desires to be merged into another bank or financial institution, two or more bank or financial institution/s so desiring to merge or be merged shall have to decide the matter first from their respective Board of Directors and submit joint application to Nepal Rastra Bank for theoretical approval stating the following matters:

- Necessity and justification for merger of bank or financial institutions and general projection of the impact it is likely to cause in the banking and financial sector and financial system,
- Latest auditor's report of bank or financial institutions to merge or be merged including the audited balance-sheets, profit and loss account, cash flow statement and net worth and so on,
- Details of management of employees of the principle and targeted institution,
- Actual report of movable and immovable assets of the merging BFIs and period of payment of liabilities,
- Details of management of employees of the merged or merging bank or financial institutions,
- Approval process under the laws concerning company and securities,
- Preliminary agreement concluded for merger by the institutions,
- Other details as prescribed by the Rastra Bank.

In case any bank or financial institution desires to acquire another bank or financial institution, the concerned two or more banks or financial institutions shall have to decide the matter first from their respective Board of Directors and submit joint application to the Rastra Bank for theoretical approval stating the following matters:

- Necessity and justification of acquisition of the BFI and general projection of the impact it is likely to cause in the banking and financial sector and fiscal system,
- Latest auditor's report of the principal institution and of the target institution/s including the audited balance-sheets, profit and loss account, cash flow statement and net worth and so on,
- Provisions made for protection of interests of the creditors of the BFI to be acquired,
- Approval process under the laws concerning companies and securities,
- Preliminary agreement concluded for acquisition of the bank or financial institution,
- Other details as prescribed by the Rastra Bank.

If the Rastra Bank is satisfied that the merger or acquisition would not have any negative impact on the development of banking and financial system of the country and in fair competition and compliance of the prevailing laws, it may give theoretical consent for moving ahead the process of merger or acquisition and while giving such approval, it may prescribe additional conditions or issue additional directives.

Provisions Concerning Valuation of Assets and Liabilities

Upon obtaining theoretical approval of merger of bank/s or financial institution/s pursuant to Section 70, such bank/s or financial institution/s shall have to appoint, on mutual consent a person, firm, company or institution that is at least capable for auditing of bank for valuation of

their respective assets, liabilities, and transactions and information thereof shall be furnished to the Rastra Bank. The bank/s or financial institution/s may carry out such valuation to be conducted before submitting application to the Rastra Bank.

Upon obtaining theoretical approval to acquire a bank or financial institution pursuant to section 70, the targeted institution shall have to get the valuation of its assets, liabilities and transactions through an auditor appointed by the General Meeting or by the Board of Director under the authority of the General Meeting. The acquiring institution may also conduct comprehensive valuation of the assets and liabilities of the targeted institution.

The terms and conditions of services of the valuator shall be as determined by the concerned bank or financial institution. While valuating the assets, liabilities, net worth, and overall transaction by the valuator, it has to be carried out according to the established norms, bases and procedures. The Rastra Bank may issue necessary directives as to the methods of valuation, bases of valuation and scope thereof.

Provisions on Agreement of Merger or Acquisition

The banks or financial institutions having obtained theoretical approval of merger or acquisition shall enter into an agreement stating the following matters unless otherwise ordered by the Rastra Bank according to this Act:

- Provisions concerning protection of interests of depositors, creditors and shareholders,
- Provisions concerning valuation system and matching of assets and liabilities of bank or financial institutions,
- Provisions concerning management of investment and transaction, inter-agency ownership and inter-agency give and take, guarantee and assurance, management of non-banking transaction, assets and liabilities,
- Merger, merging and acquisition processes, the time to be taken and costs to be incurred,
- Operation and management structure and name list of Directors,
- Matching of levels of employees of both institutions, or of the principal institution and of the target institution/s getting theoretical approval for merger or acquisition and matching of terms and conditions of services,
- Details of the shareholders with substantial ownership and of other shareholders,
- If the bank or financial institutions to be merged or acquired as a new bank or financial institution, the name, memorandum of association and articles of association, capital structure, restructuring and class thereof,
- In case of foreign bank or financial institution, the letter of consent from the concerned regulating agency,
- In the case of a foreign bank or financial institution, matters as to whether or not to acquire the business of a bank or financial institution located in Nepal, or if the entire business of such a bank or financial institution is to be sold in Nepal, matters relating thereto,
- Grievance handling system of stakeholders,
- The prevailing laws and process to be initiated for its compliance,
- Other necessary details specified by the Rastra Bank.

Approval of Merger or Acquisition

The bank or financial institutions obtaining theoretical approval for initiating merger or acquisition process shall have to adopt special resolutions from their respective General Meetings and shall submit joint application to the Rastra Bank having attached therewith the agreements of merger or acquisition and other matters prescribed by the Rastra Bank for final approval.

While carrying out enquiry into the application, the Rastra Bank may give due consideration to the facts that whether or not the merger of any bank or financial institution would create a healthy competition in the financial sector of the country, whether or not monopoly or restricted practice of any bank or financial institution may have; whether or not serious adverse impact would have cause on the overall banking and financial system on financial market and depositors and also having conducted fit and proper test of the promoter/s who may has/have significant ownership in the institution to be created after the merger, the Rastra Bank may grant final approval to the banks or financial institutions for merger with each other or acquisition by specifying terms and conditions or limitations.

The Rastra Bank shall, if it has not found to be appropriate to grant approval, notify the concerned bank or financial institution along with the reasons thereof within 45 days.

In cases if it is difficult for the institutions that have obtained approval for merger or acquisition to comply with the provisions of this Act and directives of Rastra Bank by virtue of such a merger or acquisition, the Rastra Bank may grant exemptions as specified by it on the basis of necessity and rationality.

10 VOLUNTARY LIQUIDATION OF BANKS OR FINANCIAL INSTITUTIONS

Voluntary liquidation is a situation in which a company decides to stop operating, sell its assets, pay its debts, and give back any remaining money to shareholders. Section 75 provides, any bank or financial institution willing to go for voluntary liquidation shall have to submit an application along with an action plan of voluntary liquidation to the Rastra Bank. In case the Rastra Bank is confident upon an inquiry on the application that such bank or financial institution or a branch or office of a foreign bank or financial institution is fully capable of repaying all of its credits and liabilities, it may grant theoretical consent (approval in principle), along with some terms and conditions, for voluntary liquidation. The bank or financial institution obtaining theoretical approval from the Rastra Bank shall carry out the following functions:

- To inform the Office of the Companies Registrar about obtaining theoretical approval within seven days from the date of obtaining such approval,
- To send notice to all depositors, creditors or concerned persons by fast, efficient and reliable means, about obtaining theoretical approval within thirty days from the date of obtaining such approval,
- To publish notice in national newspapers about obtaining theoretical approval within 30 days from the date of obtaining such approval,
- To carry out other acts as prescribed by the Rastra Bank.

Initiation of Voluntary Liquidation

The process of initiation of voluntary liquidation of bank or financial institution shall be deemed to have been commenced from the date of granting the final approval for voluntary liquidation by the Rastra Bank. A bank or financial institution obtaining theoretical approval for voluntary liquidation pursuant to section 75 shall fulfill the following conditions before obtaining final approval of the voluntary liquidation from the Rastra Bank:

- All the deposits and liabilities have to be refunded or fulfilled within the set time-limit,
- Operation of transactions has to be closed down and no new transaction to be carried on,
- Exercise of other powers, except those essential for voluntary liquidation shall not be allowed.

In case a person entitled to get payment of the amount and other liabilities does not come to receive the payment within the prescribed time limit or the amount to be paid for the deposits not claimed at the moment shall be deposited to an account as directed by the Rastra Bank.

An approval of voluntary liquidation will not cause any type of adverse effect on the rights and interests of the depositors and other creditors. A bank or financial institution opting for voluntary liquidation shall, upon completion of the proceedings of this Act, submit an auditing report to the Rastra Bank.

The Rastra Bank shall grant final approval for voluntary liquidation to the bank or financial institution that accomplishes the function as referred in this section and revoke the license for carrying out banking and financial transaction of such bank or financial institution.

11 COMPULSORY LIQUIDATION OF BANKS OR FINANCIAL INSTITUTIONS

Compulsory liquidation is a formal insolvency procedure which results in a company being forcibly shutdown. Section 78 provides, a bank or financial institution may be subjected to mandatory liquidation in following circumstances:

(a) In case the matured deposit or the deposit to be repaid immediately or other financial liability could not be paid on time and is due,
(b) In case capital fund of the bank or financial institution is negative,
(c) In case the Rastra Bank recommends for liquidation of a bank or financial institution based on an inspection report of the bank or financial institution,
(d) In case the shareholders with significant ownership or officials of a bank or financial institution frequently commit acts causing obstruction against the rights and interests of the depositors for the development of financial system,
(e) In case of frequent violations of the this Act and directives given by the Rastra Bank,
(f) In other situations as determined by the Rastra Bank for mandatory liquidation of banks or financial institutions

The Rastra Bank may file an application to the court for mandatory liquidation of any bank or financial institution and notice of application of such action shall be published in a daily newspaper of national level. It shall suspend entire financial transactions of such bank or financial institution immediately after submission of the application to the court. It may, while

issuing order for suspension of financial transactions, revoke the license of such bank or financial institution.

It shall include the following documents along with the application filed before the court for initiation of the process of liquidation of any bank or financial institution:

- Details along with reasons for mandatory liquidation of the bank or financial institution that the situation referred to in section 79 is prevailing,
- Financial statement of the bank or financial institution.

Any of the following persons may, with prior approval of the Rastra Bank, file application to the court by mentioning the grounds to show the situation that a bank or financial institution may be subjected to mandatory liquidation pursuant to Section 79:

- Joint application of the depositors having representation of more than 25 percent of the total deposit, who do not get the payment of the payable deposits or of more than one percent of the depositors,
- The person competent to file application for mandatory liquidation according to the prevailing law relating to insolvency.

In case the court orders for initiation of the process of liquidation of a bank or financial institution based on the application referred as above, the process of mandatory liquidation of the bank or financial institution shall be commenced from the date of passing of such an order.

Appointment of Liquidator

Section 81 provides, the Court may issue an order to the Rastra Bank to make recommendation for appointment of liquidator for initiating process of mandatory liquidation of any bank or financial institution. In case the court issues order, the Rastra Bank shall recommend names of at least 3 persons for appointment to the Liquidator within 15 days. While making recommendation to the court by the Rastra Bank, the persons having experience of the banking and financial sector from amongst the licensed insolvency practitioners according to the prevailing laws shall be recommended. The court may appoint one of the 3 persons recommended by Nepal Rastra Bank as the liquidator.

After appointment of the Liquidator as above, the Board of Directors of such bank or financial institution shall be deemed to have been ipso facto dissolved and unless otherwise ordered by the Liquidator, services of entire officials and employees appointed by the bank or financial institution shall ipso facto be terminated.

In case the Liquidator appointed as above resigns, he/she dies or the Rastra Bank deems that he/she is incompetent to perform the prescribed works, the Rastra Bank shall file application to the court according to this section to appoint another liquidator by removing such liquidator. Remuneration and terms and conditions of services of the liquidator shall be as prescribed by the court on the recommendation of the Rastra Bank.

Section 82 provides provisions relating to the functions, duties and powers of the liquidator. The liquidator appointed for the purpose of initiating the process of mandatory liquidation of bank or financial institution shall after his/her appointment carry out the following actions:

- To publish a notice in a national level Nepali and English daily newspaper for information of shareholders and other concerned persons of the bank or financial institution within 15 days of the appointment,
- To send to the Office of the Company Registrar and the institution established as per the prevailing laws for guarantee of deposits for information with an authenticated copy of the order of mandatory liquidation within 15 days of the appointment,
- To post or cause to be posted a copy of such order in a conspicuous manner at the principal place of business of the bank or financial institution and at each of its offices,
- To broadcast the notice through a national level television and radio for four weeks at least once in a week after the appointment,
- To carry out other works prescribed by the Rastra Bank.

The Office of the Company Registrar (OCR) shall make record on the concerned registration book that the order of initiating the process of mandatory liquidation has been made after getting information as above.

In addition to the functions, duties and powers as referred to elsewhere in this Act, the other functions, duties and powers of the liquidator, subject to the directives of the Rastra Bank, shall be as follows:

- To take responsibility of the office, books and accounts, records and assets of the bank or financial institution,
- To carry on most essential regular works of operation and management of the bank or financial institution,
- To carry on all the functions to be carried out on behalf of or in the name of the bank or financial institution,
- To appoint employees to render assistance in own works,
- To make necessary expenses for operation, management and liquidation of the bank or financial institution,
- To make coordination with institutions established by the prevailing laws for security of deposits,
- To exercise all the powers to be exercised by the shareholders, General Meeting, Board of Directors and officials of the bank or financial institution,
- To carry out inquiry to the business and financial status of the bank or financial institution,
- To merge or transfer entire or some of the assets and liabilities of the bank or financial institution to another bank or financial institution by getting approval of the Rastra Bank,
- To get credit in security of the assets of the bank or financial institution,
- If it is deemed that it will be beneficial for the bank or financial institution by selling any assets or terminating any contract or liability, to sell such assets or to terminate such contract or liability,
- To procure services of professional and qualified persons to assist for own functions as may be necessary,

- To hold necessary discussions and enter into compromise with any creditor or borrower of the bank or financial institution,
- To collect, protect and sell the assets of the bank or financial institution and to distribute according to this Act,
- To inquire whether or not a Director, official, employee, or any other person has committed fraud, cheating, or misrepresentation against the bank or financial institution or depositors or creditors and to take necessary legal actions against them or to file any case or initiate legal action on behalf of the bank or financial institution or to defend on behalf of the bank or financial institution,
- If anyone has been using property of the bank or financial institution, to withdraw it or to take legal actions to get such property back or cash amount from the transaction which has been declared invalid,
- To prepare report in every three months on the actions taken in the course of liquidation in the format as prescribed by the Rastra Bank and to submit the report to the Court and Rastra Bank,
- To carry out all other functions as required for liquidation of bank or financial institution,
- To carry out other functions as prescribed by the Rastra Bank.

Records of Assets and Liabilities [Sec. 84]

The Liquidator shall have to immediately prepare a record of the assets, liabilities or potential liabilities of the bank or financial institution being in mandatory liquidation as per this Act and one copy of it shall be submitted to the Rastra Bank and one copy shall be retained at the concerned bank or financial institution. The record shall have to be updated in every trimester and be made available when desired to inspect by the creditors. The record shall include the following details:

- Liabilities towards the depositors and creditors of the bank or financial institution,
- Entire assets and all types of liabilities of the bank or financial institution, and its estimated costs,
- Contracts the bank or financial institution has entered into for procuring services,
- Significant transactions the bank or financial institution has made before six months of the date of the order issued for mandatory liquidation.

Power of the Liquidator to Terminate Transactions [Sec. 85]

The Liquidator may terminate the following transactions of the bank or financial institution within 6 months of the date of order issued by the court for mandatory liquidation of the bank or financial institution:

- Any contract concluded by the bank or financial institution concerning employment,
- Any contract concluded for any services involving the bank or financial institution as a party,
- All functions and contracts being carried out by the bank or financial institution as in the capacity of a trustee,
- Any regular functions or business of the bank or financial institution or branches of bank or financial institution according to need and circumstances,
- Any liabilities said to be borne by the bank or financial institution without any limit,

- Other functions or proceedings as prescribed by the Rastra Bank.

No any type of additional amount or compensation may be claimed other than the due amount to be paid or liability to be borne by the bank or financial institution till the date of termination of the transaction.

Submission of Claims

Section 86 provides, upon initiating the process of mandatory liquidation of a bank or financial institution, the Liquidator shall, within the time prescribed by the Rastra Bank, publish a notice containing the following details asking the persons having any claim of any type with the bank or financial institution to submit his/her details of claim within one month from the last date of publication of the notice stating his/her claims and the amount he/she may receive in a clear manner:

- To publish a notice in daily Nepali and English languages newspaper of national level,
- To publish such notices at the main places of businesses of bank or financial institution and post it at every offices in a visible manner.

The creditor or other person who does not submit the claim within the time prescribed above shall not be entitled to make the claim thereafter. However, in case of the amount in depositor's account, there shall be no affect in his/her right for the reason of absence of the claim.

The Liquidator shall inquire into the claims and accept or reject the claim fully or partially based on the evidences available and information thereof shall be given to the claimant and public notice thereof shall also be published within 90 days from the date of submission of the claim.
The claimant having his/her claim partially accepted or rejected shall have to submit his/her claims again enclosing the additional evidences if any within 15 days from the date of publication of notice thereof. In case there is the need of any change in the claims made, the Liquidator may change it partially or wholly.

In case the claimant is not satisfied with the decision of the Liquidator, the claimant may file an appeal at a court within 21 days of receiving of decision of the Liquidator.

Liquidation Plan

Section 90 provides, the Liquidator shall within 30 days after completion of classification (claims accepted, partially accepted or rejected) of the claims, prepare detail plan of action of the liquidation of the said bank or financial institution and submit it to the court for approval and information thereof shall be given to the Rastra Bank as well. The following matters shall be incorporated in the liquidation plan:

- Details description of the assets and liabilities of the BFI and its nature and quantity,
- The past and projected income and expenditure of the bank or financial institution,
- Detail description as to whether to continue the current financial transactions of the bank or financial institution or to revoke them,
- Decision or order of the court,

- Details of the actions taken for compensation from the Director, official or employee for the offences and other unlawful acts they have committed,
- Details description as to classification of claims and priority order of payment,
- Plan of sale and liquidity of the main asset or group of assets of the BFI,
- Liabilities of the bank or financial institution and table of details of the probable payment to be made to depositors and creditors within the upcoming 90 days,
- Costs and expenses of the mandatory liquidation,
- Other details as prescribed by the Rastra Bank.

The Liquidator shall update the liquidation plan on a quarterly basis. Once the liquidation plan is approved by the court, the plan shall have to be made available to the creditors of the bank or financial institution for inspection, whose claims are stated in the plan.

The Liquidator shall, in order to settle the claims according to the liquidation plan, publish and broadcast public notice stating the nature, quantity and priority order for payment of the claims.

Order of Priority for Payment of Liabilities [Sec. 94]

The bank or financial institution subjected to mandatory liquidation shall have to pay its liabilities in the following order of priority:

(a) Expenses incurred for mandatory liquidation,
(b) An amount up to the amount paid for deposits insurance security made under the prevailing laws not exceeding the limitation of total approved claimed amount of the depositor or an equivalent amount, if payment has been made to a deposit insurance security organization incorporated under the prevailing laws for security of deposit,
(c) The deposits remaining after payment made pursuant to (b),
(d) Salary, allowances and amounts for other liabilities payable to the employees of the bank or financial institution,
(e) Amount payable to the Government of Nepal, local bodies, or the Rastra Bank,
(f) Outstanding amounts payable to other banks or financial institutions as fees or valuation amount,
(g) Amounts payable to other creditors and other claims,
(h) Shareholders according to the prevailing laws.

Notwithstanding anything contained elsewhere in this Chapter, in case any creditor submits an application agreeing to accept any of the assets that was not sold while auctioning, in lieu of the amount which the bank or financial institution has to pay him/her, the Liquidator may transfer such assets to such creditor having fixed the value of such assets subject to the norms determined by the Rastra Bank.

Notwithstanding anything contained elsewhere in Chapter, in case any asset has been pledged as security for secured creditors, such asset shall be used only for fulfilling the liability towards them.

While notice has been issued under this Chapter to receive the amount or goods according to details of the claims or liabilities, if the concerned person does not come to receive the amount or

goods within the specified time, such amount or goods shall have to be kept under the responsibility of the Liquidator or other body as according to the direction given by the Rastra Bank.

Decision of Liquidation

The Liquidator of the bank or financial institution subjected to mandatory liquidation or having its license revoked by the Rastra Bank shall have to submit an application to the court for liquidation after completion of function of liquidation along with details of the activities performed. The court shall inquire on the application as may be necessary and may decide that such bank or financial institution has been subjected to mandatorily liquidation.

The Liquidator shall have to publish decision given by the court in each national level newspaper of Nepali or English language at least once and while publishing in such manner, the main points of the order of the court and the liquidation report shall have to be mentioned. Upon publication of the notice, the Liquidator shall request the Office of the Company Registrar to remove the name of the bank or financial institution from the list of registration of companies. The Office of the Company Registrar shall publish the notice of removal of the name of the bank or financial institution from the Companies Registration Book in the Nepal Gazette accordingly.

The process of mandatory liquidation of the bank or financial institution shall be completed after removal of the name of the bank or financial institution subjected to mandatory liquidation after publishing notice thereof in the Nepal Gazette and such bank or financial institution shall be deemed to have been duly dissolved.

If there is any liability of a Director, Chief Executive Officer, official, employee or shareholder of the bank or financial institution or other person under this Act or other prevailing Nepal laws, the mandatory liquidation of the bank or financial institution shall not absolve them from their respective liability.

12 ACTIONS, OFFENSES & PUNISHMENT

Regulatory Actions of Nepal Rastra Bank

Section 99(1) provides, in case a bank or financial institution is found to have violated this Act, the Rastra Bank Act, or Rules, Directives, Orders issued thereunder, the Rastra Bank may, depending upon the nature and gravity of the violation, take one or more of the following actions against the bank or financial institution:

(a) To make aware or issue warning in writing,
(b) To cause the Board of Directors to enter into deed of commitment for taking reformative steps,
(c) To issue order in writing not to violate this Act or Rastra Bank Act or Rules, Byelaws, Directives or Order framed thereunder or to take reformative steps,
(d) To prohibit distributing dividend or issuing bonus shares to the shareholders of bank or financial institution or to prohibit acts of distributing dividends or issuing bonus share,

(e) To specify limits on, or prohibit, accepting deposits or disbursing credits or the act of accepting deposits or disbursing credits by bank or financial institution,
(f) To impose complete or partial ban on transactions of bank or financial institution.

Section 99(2) provides, the Rastra Bank may suspend or revoke the license to carry out banking or financial transactions issued to a bank or financial institution in following circumstances:

(a) In case banking and financial transactions are not initiated within six months from the date of obtaining the license for carrying on banking and financial transactions,
(b) In case banking and financial transactions have been closed without obtaining approval from the Rastra Bank,
(c) In case of operation of banking and financial transactions against interests of depositors or demanded or matured deposits are not repaid or could not be repaid while on-demand,
(d) In case of violation or non-compliance of the Rastra Bank Act, this Act, and the Rules, Byelaws, Orders, Directives framed thereunder or the terms and conditions as prescribed by the Rastra Bank,
(e) In case the bank or financial institution is found to have taken license having submitted false description,
(f) In case the deposits have not been guaranteed as per the prevailing laws.

Section 99 (3) provides, in case a promoter, shareholder, Director, Chief Executive, official, employee or any other relevant person of a bank or financial institution violates this Act or Rastra Bank Act, or Rules, Byelaws, Directives or Orders issue thereunder, the Rastra Bank may, having regard to the nature and gravity of the violation, take one or more of the following actions and impose fines as well:

(a) To forfeit and freeze the shares of the concerned bank or financial institution as he/she has subscribed and to direct the Board of Directors to sell the said shares to other persons,
(b) To direct the Board of Directors to stop or suspend some or all of the facilities including meeting allowance, monthly remuneration to be entitled to Board of Directors, Director, official, employee or any other relevant person of a bank or financial institution,
(c) In case the Chairperson, Director, Chief Executive or the person to act as in the capacity of the Chief Executive or an employee is, upon an inspection or monitoring of the Rastra Bank, not found to have worked in the interests of depositors, shareholders, and licensed institution, he/she may be removed from the said position by furnishing a written notification to that effect. While taking actions under this clause, a time limit of three to fifteen days shall be given to such person to submit explanations of allegation. In case such a person is terminated from the service, he/she shall not be entitled to any compensation or benefits as referred to in the Personnel Byelaws and he/she shall be deemed to be disqualified for service in any bank or financial institution for a period of five years after such actions.
(d) In case the director, official or other employee subjected to actions does not receive the letter of taking actions or does not submit the explanation after receiving the letter while taking actions pursuant to clause (c), the Rastra Bank may inform the taking of actions against through public notice,
(e) In case any bank or financial institution is found to have taken or given remuneration or other facilities against this Act or in an unnatural manner, to recover all of such facilities or

the amount to be required for such facilities and the interests to be accrued thereon from the person gives such facilities,

(f) To issue order to the bank or financial institution to write to the concerned agency to take action against a Director, official or employee of the bank or financial institution where he/she is professionally affiliated.

Imposing of Fines by the Rastra Bank

Section 100 provides, The Rastra Bank may impose the following fines against the bank or financial institution which does not give information or documents to be given according to the this Act or Rastra Bank Act, or Rules, Byelaws, Directives or Orders issued thereunder; or which does not make available within the prescribed time the documents, description, statistics, or record as required by any officer deputed by the Rastra Bank for monitoring, inspection or supervision of the said bank or financial institution:

(a) Daily one hundred thousand rupees up to one week from the date of expiry of the term,
(b) Daily one hundred twenty five thousand rupees up to two weeks from the date of expiry of the term,
(c) Daily one hundred fifty thousand rupees from the date of expiry of the term referred to in (b) up to indefinite period of time.

In case the bank or financial institution having been imposed the fines as above does not pay the fine within three days from the date of receipt of information of the decision, the said amount shall be recovered by deducting from the amount deposited in the account of the said bank or financial institution opened at the Rastra Bank.

In case a Promoter, Director, Shareholder, Chief Executive, official, employee of a bank or financial institution or any other related person violates this Act or the Rastra Bank Act or the Rules, Byelaws framed thereunder or the Directive or Order issued thereunder, or fails to implement the directive issued by Rastra Bank pursuant to clause (b) of sub-section (3) of section 99, the Rastra Bank may impose a fine up to one million rupees having regard to the nature and gravity of the violation.

Procedures of Actions

Section 101 provides, except otherwise provided in this Act, the Rastra Bank shall follow the procedures as mentioned hereunder while taking actions pursuant to Section 99 and imposing fines pursuant to Section 100:

(a) Before taking the proposed action or imposing fines, the alleged bank or financial institution or person shall be given a written notice of seven days to defend its/his/her position, stating the nature of the act he/she has committed, short description of the act, the amount that may be imposed as fines and the proposed actions.
(b) The concerned bank or financial institution or person shall have to submit clarification in written form within seven days from the date of receiving written notice pursuant to clause (a).
(c) If the written clarification submitted pursuant to clause (b) is found to be satisfactory, the Rastra Bank may amend, delimit or dismiss the charge.

(d) If the written clarification submitted pursuant to clause (b) is not found to be satisfactory, the Rastra Bank may take action pursuant to Section 99 or impose fine pursuant to Section 100.

Control over the Licensed Institutions [Sec. 102]

Notwithstanding anything contained elsewhere in this Act, if the Rastra Bank believes that a licensed institution has violated the this Act or Rastra Bank Act or the Rules or Byelaws framed hereunder or the Orders or Directives issued hereunder or is satisfied on the basis of the inspection and supervision report of the Rastra Bank, that a licensed institution has failed or is likely to fail to perform the obligations required to be performed by the licensed institution or that a bank or financial institution has not been operated smoothly or has carried out anything contrary to the interests of its shareholders or depositors, the Rastra Bank may suspend the Board of Directors of such licensed institution for a period of maximum three years and take such bank or financial institution under own control.

After taking any licensed institution under its control, the Rastra Bank may either itself or through any appropriate person, firm, company or institution appointed by it, carry out the management of such bank or financial institution. The Rastra Bank shall, within 1 year after the management of licensed institution has been carried out by itself or through any other person, firm, company or institution, conduct or cause to be conducted financial and management audit of such institution and publicly publish a report thereof.

If the Rastra Bank is satisfied from the audit report, that the concerned licensed institution has become capable of performing the liabilities required to be performed by it or that the institution has reached a stage of operating smoothly, the Rastra Bank may take the following actions:

- To remove the suspension of the Board of Directors of the licensed institution and handover the management of the institution again to that Board of Directors, or
- To dismiss the Board of Directors of the licensed institution which has been suspended, form a new Board of Directors from amongst the shareholders of the licensed institution and handover the management of that institution to the new Board of Directors, or
- To convene the General Meeting of the licensed institution, get a new Board of Directors formed by the Meeting, and handover the management of the institution to the Board of Directors, or
- To take any other action as the Rastra Bank deems appropriate.

If the Rastra Bank is satisfied from the audit report, that the concerned licensed institution has become incapable of performing the liabilities required to be performed by it or that the institution has reached a stage of not being operated smoothly, the Rastra Bank may take any of the following two actions:

- To initiate the process of mandatory liquidation under this Act, or
- To initiate the process of settlement according to the Rastra Bank Act.

The Rastra Bank shall, prior to taking a licensed institution under its control provide an opportunity to the concerned bank or financial institution to defend itself, by providing it with a time-limit not exceeding 15 days, having regard to the situation. The concerned licensed

institution shall bear all expenses incurred by the Rastra Bank in every act and action taken by it after taking such institution under its control pursuant to this section.

Offences

Section 103(1) provides, whoever commits any of the following acts in contrary with this Act or the Rules, Byelaws, Directives, Orders issued under this Act or terms or limitation as prescribed shall be deemed to have committed an offence under this Act:

(a) Carrying out banking and financial transactions without obtaining license,
(b) Obtaining license for carrying on banking and financial transactions submitting wrong or false statements,
(c) Carrying out banking and financial transactions against the terms and limits of the license for carrying on banking and financial transactions,
(d) Carrying out foreign currency exchange related business without license,
(e) Disbursing credits or other financing against this Act,
(f) Committing irregularities while carrying out valuation in artificial price while disbursing credits, recovering credits, valuating securities, recovering loan or carrying out any act relating thereto, creating artificial price while auctioning the assets pledged as collateral, or while accepting the property as non-banking assets or while selling by accepting non-banking assets or while taking collateral,
(g) Committing irregularities by any Director, official, employee and other person while carrying out merger and acquisition, liquidating, or auditing,
(h) Attempting to commit in the offence referred to in clauses (a) to (g) or abetting to the commission of such offence in any manner.

Except in cases where a Director, official or any other person abetting (assisting) in commission of the offence referred above proves that he/she had tried his/her best effort to avoid committing such offence or that it was committed without his/her consent, the offence is deemed to have been committed by himself/herself.

Except in connection with regular transaction of the branch, in case an official or employee of a branch of a foreign bank transfers assets of such branch to another country, grants approval therefor, delegates authority to that effect, or abets the commission of such an act, it shall be deemed to be an offence under this Act.

Punishment

Section 104(1) pr\ovides, any person who commits any of the following offenses shall be liable to the following punishment and the amount shall be calculated taking into account the entire amount of transaction involved:

(a) In the case of commission of the offence as referred to in clause (a) of sub-section (1) of section 103, the amount involved shall be confiscated and the offender shall be punished with a fine up to three times of the amount involved and with imprisonment for a term not exceeding five years,
(b) In the case of commission of the offence referred to in clause (b) of sub-section (1) of section 103, the amount involved shall be confiscated and the offender shall be punished with a fine up to two times of the amount involved and with an imprisonment for a term not exceeding two years,

(c) In the case of commission of the offence referred to in clause (c), (d), (e), (f) or (g) of sub-section (1) of section 103, the amount involved, if any, shall be confiscated and the offender shall be punished with a fine equal to the amount involved and with imprisonment for a term not exceeding one year,
(d) In the case of commission of the offence referred to in clause (h) of sub-section (1) of section 103, the amount involved, if any, shall be confiscated and the offender shall be punished with a half of the punishment to be imposed on the principal offender.

While imposing fines for the offences as referred to in clause (a) to (d) of sub-section (1), if the amount involved is identified, fines shall be imposed accordingly and if no such amount is identified, a fine ranging from one million to five million rupees will be imposed.
In cases where an offence as referred to in section 103 has been committed by any firm, company or institution, punishment according to this section shall be imposed on the concerned Director, office bearer, employee or concerned person of the concerned firm, company, or institution and if such a concerned person could not be ascertained, punishment shall be imposed on the chief of the firm, company, or institution, as the case may be.

If anyone is found to have committed any offence as referred to in Section 103 and the proceeds of the offence is found to have been kept or concealed in the name of himself/herself, any family member or relative or in the name of anyone else, such property and the property accrued therefrom shall also be confiscated.

Appeal

Section 105 provides, the bank or financial institution or a Director, official or employee thereof which/who does not satisfy with the actions taken by the Rastra Bank pursuant to section 99 or punishment imposed pursuant to Section 100, may file an appeal at the court within 35 days from the date of getting order of such actions. However, while filing an appeal against an action taken pursuant to section 99 or punishment imposed pursuant to Section 100 on a bank or financial institution by any shareholder, it has to be filed by the representative of the shareholders representing at least 25 percent of the paid up capital of the bank or financial institution.

In case any Director, official, employee or any other person desires to file an appeal against the personal actions or fines, 50 % of the amount of such fines or any amount as given order to pay shall be deposited.

The Director, official or employee of any bank or financial institution who is removed or dismissed from the office shall not be eligible to become a Director, official or employee of any other bank or financial institution until a period of 5 years is expired from the date of such taking of actions or until the final decision of the case, if he/she has filed an appeal.

13 MISCELLANEOUS

Banking Secre\cy [Sec. 109]

The relationship between a bank or financial institution and its customers and information pertaining to its accounts, records, books, ledgers and statements shall not be disclosed to any person other than the concerned person. The secrecy shall not be deemed to have been violated, if the details or information of any person remained in bank or financial institution is provided in following manner:

- If the details or information is provided to the Rastra Bank pursuant to this Act or Rastra Bank Act or the Rules or Byelaws framed thereunder or the orders or directives issued thereunder or if the details or information is shared between banks or financial institutions in the course of exchanging credit information,
- If the details or information is provided to the court in connection with any litigation or any other legal action,
- If such notice or information is provided to any Committee of Inquiry carrying out investigations or prosecution, or inquiry according to the prevailing laws or to any other competent person authorized by the prevailing laws, or such information is provided to any regulatory entity.
- If any details or information is provided to the auditor in the course of auditing,
- If any details or information is provided to foreign country in accordance with prevailing laws relating to mutual legal assistance,
- If in the course of investigation of any case of specific nature, the Government of Nepal, Ministry of Finance, has made a request, accompanied by the reason therefor, for providing the details of the account of the bank or financial institution or any details of the account of any person, firm, company or institution maintained with the bank or financial institution, and if the Rastra Bank has given direction for the same.

Right to Make Claims over the Deposits [Sec. 111]

No claims of any person other than the actual depositors over the deposits made with a licensed bank or institution shall be entertained. In the event of the death of the depositor, the nominee appointed by him/ her if any, and if such nominee also dies or if no nominee has been appointed by the depositor, the surviving person from amongst his/her relatives, in the following order, shall have first right to such deposits:

(a) Husband or wife living in the joint family,
(b) Son or daughter, or adopted son or adopted daughter or widow daughter-in-law, living in the joint family,
(c) Father, mother, grandson or granddaughter living in the joint family,
(d) Husband or wife, son, daughter, father or mother, son, daughter in-law or married daughter living separately,
(e) Grandfather, grandmother, brother, nephew, niece, sister living in the same family, grandfather or grandmother living separately,
(f) Step mother living in the joint family, grandson and unmarried granddaughter towards son living separately,
(g) Elder or younger brother living separately, nephew, niece, sister, nephew, niece

(h) Uncle, widowed aunt, sister-in-law (elder or younger brother's wife), or grand daughter-in-law living in a joint family,
(i) Married sisters, grand-daughter-in-law living separately.

If there is no one in the order of priority as referred above, and as such a situation has arisen where a rightful successor according to the prevailing laws has not made any claim over the deposit, the deposit(s) shall be deposited in the Banking Development Fund of the Rastra Bank and be used for banking development.

Statement of Unclaimed Deposits [Sec. 112]

A bank or financial institution shall submit to the Rastra Bank statement of deposit accounts which have remained un-operated (dormant), and of those the title to which have not been claimed under this Act for 10 years within the first month of each fiscal year,.

A bank or financial institution shall publish a notice to collect the unclaimed deposits as referred above once in every five years in a national level daily newspaper. Details description thereof shall also be kept by the bank or financial institution in its website.

In case the unclaimed amount is not collected for a period of 20 years, such deposit shall be deposited to the Banking Development Fund of the Rastra Bank and be used for banking development.

Government of Nepal to be Plaintiff [Sec. 116]

The case relating to offenses as referred to in Section 103 shall be filed with the Government of Nepal being the plaintiff, and such case shall be deemed to have been included in Schedule 1 of the prevailing Government Cases Act. Anyone may file a complaint in writing or verbally against any Director, official, employee, borrower or any other person committing an offence referred to in Section 103 along with evidence thereof at the nearby police office. While filing such a complaint, it shall not be required to mention the name. The Rastra Bank shall extend necessary cooperation in all acts of investigation, prosecution and adjudication of the offences as referred to in section 103.

Exemption and Facilities [Sec. 119]

The Act has availed following exemptions and facilities to bank or financial institutions:

- Any mortgage deed of movable or immovable assets to be made for credit not exceeding one million rupees supplied by a bank or financial institution to any citizen of Nepal or any institution established in accordance with the laws in force for agriculture, cottage and small-scale industry, irrigation, hydropower generation and for any other enterprise as specified by the Government of Nepal shall not be required to make registration.
- The repayment period of the credit and deposits shall be as prescribed by the bank or financial institution.
- No revenue stamp fee shall be charged on any kind of deeds or documents related with the bank or financial institution.

Settlement of Disputes

Section 123 provides, in the event of any dispute incurred between banks or financial institutions, such dispute shall have to be settled in mutual consent. In case the dispute could not be settled through mutual consent, the Rastra Bank shall settle the dispute through mediation or other methods of disputes resolution as per the prevailing laws. The decision made by the Rastra Bank shall be final.

Power to frame Byelaws and Procedures [Sec. 133]

The Board of Directors may, in order to operate its institutional, administrative and business transactions in systematic manner, frame byelaws on any or all of the following matters subject to this Act and the terms and conditions, limitations and norms as prescribed by the Rastra Bank:

- On appointment, promotion, transfer, dismissal, remuneration, allowances, gratuity, pension, leave, code of conduct, discipline, and terms and conditions of services and formation of such services,
- On financial administration of the bank or financial institution,
- On writing off of credits,
- On other matters as prescribed by the Rastra Bank from time to time.

In addition to the matters as referred above, a bank or financial institution may frame procedures/guidelines on the following matters as may be necessary:

- On meeting of the Board of Directors and procedures of the General Meeting,
- On delegation of authority by the Board of Directors to Director, Chief Executive, Official or employee,
- On the terms and conditions of contract to be concluded on behalf of bank or financial institutions,
- On the procedures of the use of seal of bank or financial institutions,
- On valuation of non-banking assets to be mortgaged at time of disbursement of credits or at time of auction, On other actions and proceedings to be carried out under this Act by bank or financial institutions,
- On crushing documents and papers,
- On other matters as prescribed by the Rastra Bank from time to time.

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CHAPTER- 5

NEPAL RASTRA BANK ACT, 2058 (2002)

1. INTRODUCTION

Nepal Rastra Bank Act, 2058 was promulgated on 17th Magh, 2058. The Act repealed the previous Act of 2012 and the Currencies Act, 2040. The Act is established with the following objectives as provided in the preamble of the Act.

- To establish Nepal Rastra Bank to function as the Central Bank,
- To maintain stability of price and balance of payment and stability of the entire financial sector,
- To support sustainable development of Nepal,

Nepal Rastra Bank (*referred as 'the Bank' in the Act*), the Central Bank of Nepal, was established in 1956 under the Nepal Rastra Bank Act, 2012. The Nepal Rastra Bank established under the Nepal Rastra Bank Act, 2012 shall be deemed to have been established under Nepal Rastra Bank Act, 2058. The Bank shall be an autonomous and corporate body with perpetual succession. There shall be a separate seal for transaction of business of the Bank. The Bank may, subject to this Act acquire, utilize, retain, sell and otherwise dispose of or manage movable and immovable property. The Bank may sue in its name and the Bank may also be sued in the same name.

The Central office of the Bank shall be located at Kathmandu (currently Baluwatar, Kathmandu) and the Bank may open branch, sub-branch and other offices at any place within and outside Nepal and appoint agent or representative as per its requirement.

Section 4 provides, the objectives of the Bank shall be as follows:

- To formulate necessary monetary and foreign exchange policies in order to maintain the stability of price and balance of payment for economic stability and sustainable development of economy and manage it;
- To increase the access of the financial service and increase the public confidence towards the banking and financial system by maintaining stability of the banking and financial sectors,
- To develop a secure, healthy and efficient system of payment.
- To extend co-operation in the implementation of the economic policies of Government of Nepal.

In order to achieve the above objectives, the functions, duties and powers of the Bank shall be as follows:

- To issue bank notes and coins;
- To formulate necessary monetary policies in order to maintain price stability and to implement or cause to implement them;
- To formulate foreign exchange policies and to implement or cause to implement them;
- To determine the system of foreign exchange rate;
- To manage and operate foreign exchange reserve;

- To issue license to commercial banks and financial institutions to carry on banking and financial business and to regulate, inspect, supervise and monitor such transactions;
- To act as a banker, advisor and financial agent of Government of Nepal;
- To act as the banker of commercial banks and financial institutions and to function as the lender of the last resort;
- To establish and promote the system of payment, clearing and settlement and to regulate these activities;
- To operate open market transactions through necessary equipment for liquidity management,
- To implement or cause to implement any other necessary functions which the Bank has to carry.

Functions not to be Carried Out by the Bank

Section 7 provides, except otherwise provided for in this Act, the Bank shall not carry out the following functions:

- Providing any loan, accepting any type of deposit or making any type of financial gift,
- Purchasing shares of any commercial bank, financial institution, public corporation or a company or acquiring any type of proprietary right in any financial, commercial, agricultural, industrial or other institution,
- Carrying out any type of trade, and
- Acquiring right over movable and immovable property by way of purchase, lease or in any manner whatsoever. However, the Bank may acquire such property as required for carrying out its function or for achieving its objectives.

Sub-section (2) provides authority to the Bank to carry out the following functions:

- To provide loan to its own employees.
- To provide loan to and invest in the shares of the 'institutions which carry out the functions helpful in carrying out the function of the Bank or in attaining its objectives', not exceeding ten percent of the total capital of such institutions.

Explanation: "Institutions which carry out the functions which are helpful in carrying out the functions of the Bank or in attaining its objectives" means any institutions, companies which are exclusively engaged in evaluating, managing, protecting the security, restructuring and transferring the securities of commercial banks or of financial institutions, carry out the function of credit rating, exchange of credit information, process and transmit data, print financial instruments, clearing payments, liquidate property, produce bank notes and coins and act as trustee and any other institution or companies established for carrying out similar function as prescribed by the Bank.

Privileges and Facilities to the Bank [Sec. 8]

Notwithstanding anything contained in the prevailing laws, the Bank shall be entitled to the following privileges and facilities:

- Exemption from all types of taxes, fees and charges on the incomes, capital transactions, houses, land, assets, etc.
- No requirement for the payment of registration fee for registration of the deeds of loan or refinance to be given by the Bank,
- No requirement of revenue stamps on any of the documents relating to the Bank,
- There would be no tax, fee, charge, duty on the export and import of bank notes, coins, gold, silver and the paper, metal, chemicals, and other materials to be used for printing bank notes and minting coins.

Operation of Accounts

Section 13 provides, the Bank may open and operate account for Government of Nepal and other governmental bodies, commercial banks and financial institutions, public corporations, foreign diplomatic missions, foreign central banks, foreign banks and international organization, associations. The procedures for opening and operating such accounts shall be as prescribed by the Bank. The Bank shall not operate account for any individual, industry and political organization.

2 FORMATION AND FUNCTIONS, DUTIES AND POWERS OF BOARD

Section 14 provides the provisions on formation of the Board of the Bank. The Board shall consist of the following members:

(a) Governor - Chairperson
(b) Secretary, Ministry of Finance - Member
(c) 2 Deputy Governors - Member
(d) 3 Directors appointed by the Government of Nepal from amongst the persons renowned in economic, monitory, banking, finance and commercial law sector - Member

Appointment of the Governor, Deputy Governor and Directors

Section 15 provides, Government of Nepal, the Council of Ministers shall appoint Governor on the basis of the recommendation of the Recommendation Committee formed as follows:

(a) Minister of Finance - Chairperson
(b) One person from among the former Governors - Member
(c) One person designated by Government of Nepal from amongst the persons renowned in economic, monitory, banking, finance & commercial law sector - Member

The Recommendation Committee shall recommend to Government of Nepal, the Council of Ministers the names of 3 persons renowned in the field of economic, monetary, banking, finance, commerce, management, commercial law and from among the Deputy Governors. Government of Nepal, the Council of Ministers shall appoint one person to the Office of Governor out of the names recommended by the Recommendation Committee.

Government of Nepal, the Council of Ministers on the recommendation of Governor, shall appoint Deputy Governor. The Governor shall, while making recommendation for appointment of Deputy Governor, recommend names, double in number of the post falling vacant from

among the special class officers of the Bank on the basis of their performance and capability. Person appointed in the post of Deputy Governor under this section shall be deemed to have been automatically retired from the service of the Bank.

Section 17 provides, Government of Nepal, the Council of Ministers shall appoint Directors. Government of Nepal, the Council of Ministers shall, while appointing Directors appoint them each representing different sectors from amongst the persons renowned in economic, monetary, banking, financial, commercial, management and commercial law sectors.

The tenure of Office of the Governor, Deputy Governor and Directors shall be of five years. Government of Nepal may reappoint the retiring Governor for one term and the retiring Directors for any term, if it is deemed necessary.

Government of Nepal shall normally one month prior to the vacancy in office of the Governor, make appointment to the office of Governor in accordance with this Act and issue and transmit public notice of such appointment.

In cases the office of the Governor, Deputy Governor and Director falls vacant before expiry of the tenure of office, Government of Nepal shall appoint appropriate person to such office for the remaining term of office pursuant to the provisions made under this Act.

Government of Nepal shall depute the senior Deputy Governor of the Bank as Acting Governor to discharge the functions of the Governor in cases where the Governor dies or resigns from office, falls sick, goes on leave or is unable to discharge his/her duties due to any reason.

The Governor, Deputy Governor or Director may resign from his/her office by tendering a written resignation to Government of Nepal (section 24).

Qualifications and Disqualification of the Directors [Sec. 20]

In order to be appointed to the post of Governor, Deputy Governor and Directors, a person shall have to meet the following qualifications:

- A Nepalese citizen,
- Having higher moral character,
- Not disqualified under section 21,
- Having ‘work experience’ in economic, monetary, banking, financial and commercial law sectors after having attained at least master's degree in economics, monetary, banking, finance, commerce, management, public administration, statistics, mathematics and law.

Explanation: "Work experience" means the experience of works in the post of special class of Government of Nepal or of the Bank; or in the post of a university Professor, or in the post of Executive Chief of class ‘A’ of a commercial bank or of a financial institution or in the post of Executive level of international association, institution or in the equivalent post or in the post higher than those in terms of the order of protocol.

Section 21 provides, following persons shall not be eligible for appointment to the Office of the Governor, Deputy Governor and Director:

- Member or official of a political party, or
- The person blacklisted in relation to transaction with a commercial bank or financial institution, or
- An official currently engaged in any commercial bank or financial institution, or
- A person having five percent or more shares or voting right in a Commercial Bank or financial institution, or
- A person rendered bankrupt for being unable to pay debts to creditors, or
- An insane person, or
- A person convicted by a court in an offence involving moral turpitude.

Grounds for Removal of the Directors from Office [Sec. 22]

Government of Nepal, the Council of Ministers shall remove the Governor, Deputy Governor and Director on any of the following grounds:

- If one is disqualified to become a Director pursuant to section 21, or
- The lack of capability to implement the functions which the Bank has to carry out in order to achieve the objectives of the Bank under this Act, or
- If one has committed any act causing loss and damage to the banking and financial system of the country, or
- If one is found to have acted dishonestly or with malafide intention in any transaction related to the business of the Bank, or
- If professional license is revoked or prohibited from carrying out any profession rendering disqualified to be engaged in any trade or profession on the ground of gross misconduct, or
- If one is absent for more than three consecutive meeting of Board without a genuine reason.

Once Government of Nepal initiates the process for removing the Governor, Deputy Governor and Director, they shall be deemed to have been ipso facto suspended from the office. However, Government of Nepal shall not deprive the concerned person from a reasonable opportunity to defend himself/herself prior to remove him/her from his/her office.

Government of Nepal shall remove the Governor from his office pursuant to above on the recommendation of an Inquiry Committee constituted under Section 23. Section 23 provides, Government of Nepal shall prior to removing the Governor from office, constitute an Inquiry Committee consisted as follows, and remove the Governor from the Office on the basis of the recommendation of such committee:

(a) The person designated by Government of Nepal from amongst retired Justices of Supreme Court-Chairperson
(b) 2 persons designated by Government of Nepal from amongst renowned persons belonging to economic, monetary, banking, financial, commercial or management sector-Member

The Inquiry Committee may record the statement and conduct inquiry with the concerned person prior to submission of its recommendation to Government of Nepal along with its findings. The Inquiry Committee may fix its procedure to be followed in connection with the inquiry. The Inquiry Committee shall submit its recommendation along with its findings to Government of Nepal within one month.

While removing a Director or Deputy Governor pursuant to above, Government of Nepal shall cause to conduct an inquiry by committee and remove him/her from the office on the basis of the recommendation made by the committee.

Meeting of the Board [Sec. 28]

The Governor shall preside over the meeting of the Board. The meeting of the Board shall be held as per the requirement of the Bank. However, the Board shall meet at least once in a month. The Governor shall call on the meeting of the Board. In case of a written request from three Directors of the Board to call the meeting of the Board, the Governor shall call the meeting of the Board. The Board may frame a separate bye-law with regard to the procedures for calling the meeting of the Board, conducting the meeting, voting, keeping minutes and for other matters.

The presence of at least three Directors and of the person presiding over the meeting of the Board shall constitute the quorum for the meeting of the Board. However, out of the three Directors presented in the meeting at least one director should be the director appointed under Clause (d) of Section 14.

The decision of the majority shall be the decision of the Board. In the event of a tie of votes for and against a resolution, the person presiding over the meeting shall exercise a decisive vote.

Functions, Duties and Powers of the Board [Sec. 29]

The functions, duties and powers of the Board shall be as follows:

- To frame monetary and foreign exchange policies,
- To take necessary decisions with regard to the denominations of bank notes and coins, the figures, size, metal, materials for printing notes, and other materials; and to frame appropriate policies with regard to their issue,
- To frame necessary policies for causing the supervision and inspection of commercial banks and financial institutions and banking and financial arrangement,
- To approve Rules and Bye-laws of the Bank and to frame policies applicable to the operation and management of the Bank,
- To frame policies with regard to the appointment, promotion, transfer, dismissal, remuneration, pension, gratuity, provident fund, leave, code of conduct and other terms and conditions relating to the service of the employees of the Bank,
- To approve the annual programs and budget of the Bank and the annual auditing of accounts, and to submit its report to Government of Nepal for information,
- To approve the annual report on the activities of the Bank,
- To frame necessary policy for the issue of license to commercial banks and financial institutions and for revoking such license,
- To approve the limit of the loan to be provided to Government of Nepal by the Bank,
- To fix the amount, limit and terms and conditions of the loan and refinance which the Bank provides to the commercial banks and financial institutions,
- To make decision with regard to the Bank's membership to international organizations, associations,

- To frame policy for the mobilization and investment of Bank's financial resource,
- To submit proposal to Government of Nepal along with the reasons if it is necessary to make amendment to this Act,
- To take decision on all other matters excluding the matters which are within the authority of Governor under this Act,
- To delegate the powers vested on the Board to the Governor or the subcommittee constituted by the Board with or without fixing the time limit.

Functions, Duties and Powers of the Governor [Sec. 30]

The functions, duties and powers of the Governor shall be as follows:

- To implement the decisions made by the Board,
- To operate and manage the Bank,
- To systematize the functions to be carried out by the Bank,
- To represent and cause to represent on behalf of the Bank in international organizations and associations,
- To implement and cause to implement the policies relating to monetary and foreign exchange matters,
- To formulate necessary policy on rates of interest for deposits and loan with commercial banks and financial institutions,
- To formulate necessary policies with regard to the rates of interest to be paid by commercial banks and financial institution on deposit and loan or the rate of interest to be charged by them on deposits and loan,
- To formulate necessary policies relating to liquidity to be maintained by commercial banks and financial institutions,
- To make necessary arrangement with regard to the basis, amount, methods, conditions and duration of compulsory deposit to be maintained by commercial banks and financial institutions, and its use,
- To fix the terms and conditions relating to adequacy of the capital fund of commercial banks and financial institutions,
- To take decision with regard to the procedures and terms and conditions to be followed while purchasing and selling gold and other precious metals,
- To fix the charge on the services to be provided by the Bank,
- To take decision for opening and closing branch offices and other offices of the Bank as may be necessary,
- To establish and close the agency of the Bank,
- To make necessary arrangement for development and operation of information system of the Bank,
- To make necessary arrangement for supervision of commercial banks and financial institutions,
- To take decision with regard to revocation of the license provided to commercial banks and financial institutions,
- To take decisions on any other matters subject to the powers delegated by the Board of Directors

The powers to be exercised by the Governor of a Central Bank in accordance with international practice shall be vested in the Governor. The Governor may in order to conduct the business of the Bank in a smooth manner, delegate authority vested with him/her under this Act to the Deputy Governor or other employees.

Management Committee [Sec. 33]

There shall be a Management Committee under the Board in order to conduct the business of the Bank in a smooth manner consisting of the following members:

(a) Governor	Chairman
(b) Two deputy Governors	Member
(c) One senior officer of the Bank designated by the Governor	Member-secretary

The functions, duties and powers of the Management Committee shall be as prescribed. The Governor may invite any of the officers to take part in the meeting of the Management Committee.

The Committee shall in connection with discharging its functions, evaluate the country's monetary and financial condition on a periodic basis. For this purpose, the Management Committee shall submit a report to the Board on the Bank's administration and operation, operation of monetary and other regulatory policies, the soundness of the banking system of the country, condition of money, capital and foreign exchange market, implementation of such policies and impact they may have and situation on the banking system, and on the significant events, at least once in a month.

Audit Committee

Section 34 provides, the Board shall constitute an Audit Committee comprising of the following members which will be accountable to the Board:

(a) One Director designated by the Board	Convener
(b) One expert in the concerned subject designated by the Board	Member
(c) Chief of Internal audit department of the Bank	Member-Secretary

The functions, duties and powers of the Audit Committee shall be as follows:

- To submit its report and recommendations to the Board on accounts, budget and audit procedures and control system of the Bank,
- To ascertain whether or not the audit and preparation of periodic balance sheet and other documents of the Bank have been carried out properly,
- To supervise the implementation of the appropriate risk management adopted by the Bank,
- To audit managerial and performance of works of the Bank in order to be assured that the prevailing laws applicable to the Bank have been fully complied with,
- To frame bye-law for auditing of the Bank in accordance with the prevailing laws and international auditing standard and to submit it to the Board for approval.

Professional Code of Conduct and Confidentiality [Sec. 37]

The Governor and Deputy Governor shall, so long in office, fully devote his/her professional service to the Bank. Except nominated by the Bank they shall not be entitled to assume any type of office or accept job in or render services to anyone else with or without remuneration. However, they may render services by assuming any post in any non-profit making organizations such as Medical Association, Engineers Association, Bar Association, Bankers Association, and Chartered Accountants Association and in any other trade and professional organization.

The Governor, Deputy Governor or Director shall have to provide highest priority to the interests of the Bank while discharging their official duties. They shall not accept personally or through any person having any commercial, financial relationship with him, any type of gift or loan in a manner that may cause undue influence of any type in discharging his duties.

The Governor, Deputy Governor or Director or employees, Advisor, Auditor, Agent or Representative of the Bank shall not be allowed to be engaged in the following acts and activities:

- To divulge any published or unpublished confidential information or notice that came to his knowledge while exercising his official duty to any other person, or
- To use such information or notice for personal gain.

Any published or unpublished information in one's knowledge may be divulged on the following grounds in the manner prescribed by the Bank:

- Providing such information while discharging one's duties in public, while assisting law enforcement agencies, as per the order of the court or of the authorized officer,
- Providing such information, in connection with discharge of his/her duties, to the external Auditor of the Bank and the employees of international financial institutions, and
- Providing such information in connection with legal actions for the sake of the Bank's interests.

3 FINANCIAL PROVISIONS AND OPERATION OF OPEN MARKET

The Capital of the Bank shall be five billion rupees. The Capital of the Bank shall be received from Government of Nepal and this Capital shall not be transferred or any burden of debt be placed upon it. Government of Nepal may alter the capital in consultation with the Bank.

Computation of Net Profit or Loss [Sec. 40]

The Bank shall prepare the account of its profit and loss in each Fiscal Year. While preparing the account of profit and loss, it shall be prepared as per Nepal accounting standards. It shall consider International Accounting Standards as basis in connection to the sectors, not mentioned or specified in Nepal Accounting Standards. While preparing the account of profit and loss, net profit shall have to be determined by deducting bad or doubtful debts and deducting depreciation of property upon making adjustment of the profit made by the Bank, loss sustained or yet to be sustained and net valuation profit or loss.

Allocation of Net Profit [Sec. 41]

If the Bank makes net profit in any fiscal year, allocation and use of such profit shall have to be made as follows:

(a) The amount equal to revaluation profit from the net profit shall have to be separated and kept in revaluation reserve fund.

(b) Five percent distributable amount of the net profit remained after separating the amount as per (a) shall have to be kept in monetary liability fund; the amount fixed by the Board so as not to be less than 10 % in general reserve fund; 5 % amount in financial stability fund and the amount as fixed by the Board shall have to be kept in net accumulated savings fund.

(c) After the amount is appropriated as per (b), the Board shall appropriate the amount to other funds as per necessity and have to submit the rest of the amount to the Government of Nepal.

The amount of general reserve fund and accumulated savings fund can be used for the sake of increasing the capital of the Bank as well. The allocations of other amount other than mentioned above shall be as per the provision made in the Rule.

Allocation of Net Loss [Sec. 42]

If the Bank sustain net loss in any fiscal year, such loss shall be allocated as follows:

(a) If revaluation profit is also included in the net loss, revaluation profit shall have to be kept in revaluation reserve fund.

(b) If revaluation loss is also included in the net loss, revaluation loss shall have to be written as loss in revaluation reserve fund. If revaluation loss exceeds the amount remained in revaluation reserve fund, the surplus loss amount shall be written as loss in the following fund and account in a sequence of priority:
   (i) In accumulated savings fund, up to the amount deposited in accumulated savings fund,
   (ii) In general reserve fund, if loss amount remains after the adjustment in the accumulated savings fund as per (i), and
   (iii) In capital account, if loss amount remains after adjustment in accumulated savings fund and general reserve fund as per (i) and (ii).

(c) The operation and other losses except for the revaluation profit as per (a) and revaluation loss as per (b), shall have to be written as loss in accumulated savings fund.

(d) If loss amount is more than the amount remained as deposit in accumulated savings fund, the surplus loss amount shall have to be written in following fund and account as loss in a sequence of priority:
   (i) In general reserve fund, up to the amount deposited in general reserve fund,
   (ii) In capital account, if loss amount remains after the adjustment in the general reserve fund as per (i).

The Government of Nepal shall bear the loss that could not be adjusted while allocating loss as above.

Operation of Open Market [Sec. 45]

The Bank shall operate open market transaction on the basis of agreements for immediate or late purchase and sale of debt securities issued on behalf of Government of Nepal or by the Bank itself or prescribed debt securities. It may make repurchase or reverse repurchase agreements against the security of debt securities issued on behalf of Government of Nepal or by the Bank itself for the short term liquidity management. It may also issue other necessary instrument for the operation of open market.

Compulsory Deposit of Commercial Banks and Financial Institutions [Sec. 46]

The Bank shall issue directives to the commercial banks and financial institutions to maintain compulsory reserve with the Bank in proportion to the deposits accumulated with them, borrowed fund or other liability prescribed by the Bank. It shall be the duty of commercial banks and financial institutions to maintain the compulsory deposit in the Bank as prescribed by the Bank. While computing the compulsory deposit of commercial banks and financial institutions, the Bank shall compute on the basis of daily average of deposit by prescribing the duration.

In cases where any commercial bank or financial institution fails to maintain the compulsory deposit prescribed by the Bank, the Bank shall impose a fine on bank or financial institution for the period of such failure. While imposing the fine, the amount of fine shall not be more than three times of the maximum of the bank rate prescribed by the Bank.

Loan and Refinance to Commercial Banks and Financial Institutions

Section 49 provides, the Bank may subject to the terms and conditions prescribed by it, make available loan and refinance to commercial banks and financial institutions for a maximum period of one year against the security of the following assets:

- International negotiable instrument (Bill of exchange, promissory note, certificate of deposit, bonds, and other debt instrument payable in convertible foreign currencies issued by any debtor or liability holder and held by the Bank),
- The debt bond issued by Government of Nepal payable within Nepal,
- The deposits accumulated in the Bank or the gold and precious metals, which the Bank may transact under this Act,
- The bill of exchange or the promissory notes referred to in Sub-section (1) of Section 48,
- Other securities as prescribed.

The Bank may also provide any type of credit to a commercial bank and financial institution for a maximum period of one year in cases where Government of Nepal has for the sake of public interest and welfare, deemed it appropriate to provide loan and has requested the Bank therefor and, Government of Nepal has given a guarantee of securities of prevailing market rate for such loan or in extraordinary circumstances where the Bank has to work as a lender of the last resort.

The Bank may renew the credit provided as above for another one year subject to prescribed terms and conditions. The Bank shall fix the rate of interest for refinance from time to time and publish and transmit the notice of interest rate for the information of all concerned.

4 MONETARY UNIT, BANK NOTE AND COINS

The Rupee (divided in 100 paisa) shall be the monetary unit of Nepal. It shall be a legal tender within Nepal and Government of Nepal shall provide guarantee for such Rupee.

Bank Notes and Coins

Section 52 provides, the Bank shall have monopoly over the issue of banknotes and coins in Nepal and such notes and coins shall be legal tenders in Nepal.

The Bank shall issue notes only against the security and the liability of such issued notes shall be equal to the value of property kept as security. At least 50 % of the property to be kept as security shall be one or more of gold, silver, foreign currency, foreign securities, and foreign bills of exchange and remaining percentage shall be one or more of the coins (Mohar Double or coins of higher denomination), the Debt Bond issued by Government of Nepal, the promissory note or bills of exchange payable in Nepal within a maximum of 18 months from the date of repayment by bank. However, with the permission of the Government of Nepal the ratio of property kept as security may be at least 40 % one or more of gold, silver, foreign currency, foreign securities, and foreign bills of exchange and the remaining percentage shall be one or more of the coins (Mohar Double or coins of higher denomination), the Debt Bond issued by Government of Nepal, the promissory note or bills of exchange payable in Nepal within a maximum of 18 months from the date of repayment by bank.

The valuation of property for the purpose of calculating security shall be made as follows:

- The price of gold at the rate fixed by Government of Nepal on recommendation of Board,
- The price of silver at the rate deemed appropriate by the Board,
- The foreign currencies at the exchange rate fixed by the Bank,
- The Debt Bond issued by Government of Nepal, the foreign securities and Bills of Exchange at the rate deemed appropriate by the Board on the basis of market rates,
- Coins at the rate of face value.

The Bank shall issue the bank notes of various denominations as may be necessary. While issuing banknotes, figures appearing in the notes, size & denominations shall be as approved by Government of Nepal and figures not apparent in the notes, internal security arrangements, materials for printing banknotes and other materials shall be decided by Board.

Government of Nepal may, in consultation with the Board, declare that banknote of any denomination shall cease to be legal tender in any place other than the prescribed place or office by publishing a notification in the Nepal Gazette. The Bank shall not reissue the notes, which are torn, defaced or excessively soiled.

The Bank may mint and bring into circulation the coins of whatever metal or mixture of metals or bring into circulation having minted them in mint on special occasions with the approval of Government of Nepal. The Bank may also cause such coins minted in any foreign mint, if deemed necessary. If coins minted once with the approval are to be re-minted, no approval of Government of Nepal shall be required. The Bank may mint the coins sent for minting by a foreign government with the approval of Government of Nepal.

Soiled or Counterfeit Currency and Currency Recall

Counterfeit coin means a duplicate coin minted copying the coin issued by the Bank or a counterfeit coin prepared by melting or manipulating or a coin prepared by cutting and breaking into two or more places a coin issued by the Bank or the coin the figures, letters and signs in which have been defaced. Section 59 provides, the Bank may forfeit without any compensation, the coins or notes the outer appearance of which is changed, or which is counterfeit coins or fake note.

The Bank may withdraw, destroy or replace the soiled currency with other banknote or coin. The Bank may withdraw or destroy such banknotes or coins with or without compensation to the owner of the banknotes. The Bank may deny to replace the banknote or coin if the design has been deleted, or is torn, defaced or more than fifty percent of its portion has been destroyed. No owner of lost or stolen banknotes or coins shall be entitled to a reimbursement from NRB.

Section 60 provides the provision on currency withdrawal. The Bank may recall the bank notes and coins in circulation within Nepal by issuing in exchange other bank notes and coins in equivalent amount. The Bank shall publish and transmit public notice clearly specifying the period during which the bank notes or coins shall be presented for exchange and where they are to be so presented.

Bank notes and coins to be exchanged shall cease to be a legal tender upon expiry of the prescribed time. The Bank may cut, break or demolish or destroy in any manner the banknotes and coins withdrawn from circulation and the currency with defect, as prescribed.

Prohibition on Reproduction and Counterfeiting of Currency [Sec. 61]

No one shall commit or cause to commit any of the following acts:

- To forge, counterfeit or alter banknotes and coin in circulation as legal tender in Nepal or any cheques or payment card or to do any other act relating to it or to assist in any of such acts,
- To possess, transport or issue any banknote or coin or cheque or payment card with the knowledge that such banknote or coin, cheque or payment card was falsely made, forged, counterfeited or altered or to assist in such acts in any manner,
- To possess, transport any sheet of metal, stone, paper, die or any other material or substance with the knowledge that it was intended to be used in falsely making, forging, counterfeiting or altering any banknote or coin, cheque or payment card or to assist in any of such acts.

Any reproduction of banknotes, coins, checks, securities or payment cards, denominated in Rupee, and the creation of any objects that by their design imitate any such banknote, coin, check, security or payment card shall require the prior written authorization of the Bank.

5 FOREIGN EXCHANGE POLICY, REGULATION AND RESERVE

The Bank shall have full authority to formulate, implement and cause to implement foreign exchange policy of Nepal. The Bank shall manage the foreign exchange. The Bank shall have the following powers for such management:

- To issue license under this Act or any other prevailing laws to the persons willing to deal in foreign exchange transaction,
- To frame Rules and Bye-laws and to issue necessary order, directives or circulars in order to regulate dealings in the foreign exchange transaction by the foreign exchange dealer,
- To inspect, supervise and monitor the foreign exchange dealer,
- To set the bases, limitations and terms and conditions for the transaction of the foreign exchange dealer,
- To prescribe the system of determining the foreign exchange rates of the Nepalese currency.

The Bank shall cause the license holder to submit to the Bank the detailed particular of exchange of foreign currency and of the transaction relating to it. The duration for submitting such particulars, the format and other documents relating to it shall be as prescribed by Bank from time to time. It shall be the duty of the concerned license holder to submit the particulars and the documents prescribed by the Bank.

Dealing in Foreign Exchanges [Sec. 65]

Foreign Exchange means foreign currency, all types of deposits, credits, stocks, foreign securities payable in foreign currencies and cheques, drafts, traveler's cheques, electronic fund transfer, credit cards, letters of credit, bills of exchange, promissory notes in international circulation payable in foreign currencies; and also includes whatsoever, type of other monetary instrument as the Bank may prescribe, as per the requirement, by publication and transmission of public notice. The Bank may purchase and sell foreign exchanges, gold and precious metals. The purchase and sale to be made by the Bank shall be effected through the spot, advance exchange rate, swap, option or the similar types of other instruments, cash or negotiable instrument.

The Bank may also purchase or sell foreign exchange for maintaining foreign exchange reserve. It may affect such purchase and sale also on the basis of spot, advance exchange rate, swap, option or similar types of other of instruments.

The Bank shall deal in foreign exchange after fixing its buying and selling rates. The basis, limitations and conditions of such dealing shall be as prescribed by the Bank.

Foreign Exchange Reserve

Section 66 provides, the Bank shall mobilize the foreign exchanges reserve. Such reserve shall be denominated in the respective foreign exchange and held in its balance sheet. The reserve shall consist of the following assets:

- Gold and other precious metals held by or for the account of the Bank,
- Foreign currencies held by or for the account of the Bank,
- Foreign currencies held in the accounts of the Bank on the books of a foreign central bank or other foreign banks,
- Special drawing rights held by the Bank at the International Monetary Fund,
- Bill of exchange, promissory note, certificate of deposit, bonds, and other debt instrument payable in convertible foreign currencies issued by any debtor or liability holder and held by the Bank,
- Any forward purchase or repurchase agreements of the Bank concluded with or guaranteed by foreign central banks or public international financial institutions, and any futures and option contracts of the Bank providing for payment in freely convertible foreign currency.

The Bank shall give due consideration to its capital and liquidity to maximize earnings while selecting the assets referred above. It shall maintain international reserve at a level, which shall be adequate for the execution of monitory and exchange rate policies and for the prompt settlement of the international transaction.

If international reserves have declined or in the opinion of Bank are in danger of declining to such an extent as to jeopardize (put at risk) the execution of the monetary or foreign exchange policies in the prompt settlement of the country's international transactions, it shall submit to Government of Nepal a report on the international reserves position and the causes which have led or may lead to such a decline, together with such recommendations as it considers necessary to remedy the situation. The Bank shall make further such report and recommendations to Government of Nepal until such time as the situation has been rectified.

6 RELATION WITH GOVERNMENT OF NEPAL

The Bank shall be the banker and financial advisor of GoN and a financial agent of Nepal. Government of Nepal shall consult the Bank on any matters that are within the jurisdiction of its competence. It shall be the duty of the Bank to advice on matter consulted by the Government of Nepal. Government of Nepal shall, while preparing annual budget, consult the Bank on the domestic debt including overdrafts. The Bank shall submit a pre-budget review report to Government of Nepal each year on the economic and financial matters.

The Bank shall accept the deposits of Government of Nepal or other bodies prescribed by Government of Nepal. It shall receive and disburse monies, keep accounts therein, and provide banking services related thereto while accepting deposits. It may also authorize commercial bank or financial institution to conduct the transaction on its behalf subject to the terms and conditions prescribed by it.

The Bank shall, subject to the terms and conditions stipulated in the agreement entered into with Government of Nepal, act as fiscal agent of Government of Nepal on the following matters:

- Marketing, purchase and sell of debt bonds issued by Government of Nepal and to act as registrar and transfer agent therefor,
- Payment of the principal, interest and other fees of the debt bonds issued by Government of Nepal,
- Other necessary functions to be carried out as the agent.

Opinions and Information Relating to External Debt [Sec. 70]

Government of Nepal may consult the Bank while taking loan from external sectors. The consultation shall include the subjects such as amount of loan, the terms and conditions of the loan and the repayment of loan. It shall inform the Bank when external loans have been received. It shall consult the Bank while granting approval to private and public institutions to raise loan creating liability in foreign exchange. Government of Nepal, public institution or private sector shall inform Bank about agreements concluded having creating liability in foreign exchange.

Consultation on the Matter of Law Reform [Sec. 74]

The Bank may be consulted on any proposals by the concerned entities for legislation with respect to matters that relate to Bank objectives or that otherwise are within its fields of competence, including monetary policy and its operations, credit, the balance of payments, foreign exchange, and banking, before they are submitted for amendment or legislative action. It shall be the duty of the Bank to provide opinion.

The Bank shall have powers to submit proposals to Government of Nepal for enacting new law or amending the existing laws on the subjects relating to the objectives of the Bank or area of its competence such as monetary policies and its operation, credit, balance of payment, foreign exchange and banking.

Credits to Government of Nepal

Section 75 provides, except otherwise provided in this Act, the Bank shall not provide any type of financial assistance to Government of Nepal or an institution under the full or substantial or partial ownership of Government of Nepal. The Bank may extend credit to Government of Nepal with a condition to repay within 180 days. However, the Bank may extend a special credit of long term to Government of Nepal only on account of subscription and similar payments resulting from or incidental to the membership of Nepal with international organization.

The Bank shall disburse credit to be extended to Government of Nepal or an institution under full or substantial or partial ownership of Government of Nepal only in Nepalese rupees. The credit shall be certified by negotiable debt bond (debt bond issued in the form of promissory note) issued by Government of Nepal and delivered to the Bank and such debt security should have the maturity corresponding to the maturity of the extension of credit and should bear the interest at market rate.

There must be a written agreement executed between Government of Nepal and the Bank. Such agreement shall clearly stipulate the principal amount of the loan or limit on a line of credit, the maturity, and the applicable rates of interest and other charges.

At no time the amount of overdraft provided by the Bank to Government of Nepal shall be more than 5 % of the revenue income of Government of Nepal in the preceding fiscal year. While computing such revenue income, the amount of borrowing, grants or any other form of financial assistance or income received from the sale of property shall not be included. Government of Nepal shall make the payment of the overdraft within 180 days at the prevailing interest rate either in the form of cash or marketable debt bond.

Sub-section (7) provides, the total amount of debt bond purchased by the Bank from Government of Nepal and taken into its ownership shall not be more than ten percent of the revenue income of the preceding fiscal year.

Sub-section (8) provides, the debt bond issued by Government of Nepal and purchased by the Bank shall not be treated as the credit extended under sub-section (7) in the following circumstances:

- If the purchase is made in the secondary market for the operation of open market consistent with the monetary policy of the Bank,
- If the purchase is made in the primary market, when it is necessary in the opinion of the Bank, to maintain stability in the market at the time of primary issue of such securities and such securities are divested within 60 days of purchase,

The debt bond purchased by the Bank from Government of Nepal and retained in its ownership prior to the commencement of sub-section (7).

7 REGULATION, INSPECTION & SUPERVISION OF BANK/FINANCIAL INSTITUTION

Any person, firm, company or institution shall, in order to accept any type of deposit or to provide loan, obtain approval from the Bank as may be prescribed. The Bank may grant approval by prescribing the terms and conditions. It shall be the duty of the concerned person, firm, company or institution to abide by such terms and conditions.

An individual, firm, company or organization authorized to accept deposit or to provide loan pursuant to prevailing laws, shall fix the rate of interest payable on deposit and to be charged on loan subject to arrangement prescribed by the Bank in the matter of rate of interest from time to time.

Commercial Banks and financial institutions shall obtain license from the Bank as prescribed in order to conduct banking and financial transaction. The Bank may fix necessary terms and conditions while issuing license, and it shall be the duty of the licensed bank and financial institution to abide by such terms and conditions.

Regulatory Powers of the Bank

Section 79 provides, the Bank shall have full powers to regulate the functions and activities of banks and financial institutions. The Bank may frame rules and bye-laws on the matters which the Bank deems appropriate and issue necessary order, directives and circular to regulate the banks and financial institutions. It shall be the duty of the concerned bank and financial institution to abide by such Rules, Bye-laws, order, directives and circular.

The Bank shall issue appropriate directives to banks and financial institutions and require them to submit the following particulars:

- Its balance sheet accounts, off balance sheet commitments, statement of income and expenditures and their ratio among accounts or items.
- Prohibitions, restrictions or conditions concerning specific types or forms of credit or investments of a risk-bearing nature which are not matching as to maturity of assets and liabilities and off-balance-sheet items, foreign currency, spot or advance rate of interest, swap, option or similar instruments or access to the payments system through electronic or other means.
- Other particulars and documents prescribed by the Bank.

For the purpose of preventing financial investment in the money laundering and terrorist activities, the Bank may give necessary directives to the commercial banks and financial institutions regarding providing Financial Information Unit (FIU) established as per existing law relating to money laundering prevention, knowing the customers and classifying and managing the risk of the customers, the description of the limit including money transfer, deposit, or doubtful transaction.

The Bank shall have the following powers with regard to commercial banks and financial institutions:

- To enforce authority and responsibility granted under this Act and any other Act enacted for licensing, supervising and regulating commercial banks and financial institutions and to revoke the license of commercial banks and financial institutions and to take over or to provide in trusteeship the commercial banks or financial institutions which have been declared insolvent or are on the verge of insolvency,
- To investigate or inspect, or supervise or to cause to investigate, inspect or supervise by any official of the Bank or the person designated by the Bank the books and accounts, records, documents or register of commercial banks or financial institutions in order to find whether or not any commercial bank or financial institution has conducted business and transaction in accordance with the provision made under this Act or the Rules, bye-laws framed thereunder and an order or directive issued thereunder,
- To issue order to the member of the Board of Directors, official or employee of any commercial bank or financial institution to provide necessary information about the bank or institution in cases where it is necessary to inspect and supervise the transaction of such bank or financial institution.

Section 81 provides, the Bank may direct to banks and financial institutions to advance credit in the sectors prescribed by the Bank from time to time for a prescribed period and in the manner

prescribed by the Bank. If any bank or financial institution does not advance the credit as such or advance credit less than prescribed amount, the Bank may recover as fine an amount equal to the interest which a commercial bank or financial institution would have charged for the amount of credit not advanced or advanced less than the prescribed amount from the concerned commercial bank or financial institution.

Inspection and Supervision [Sec. 84]

The Board shall frame and implement inspection and supervision by-law confirming to international standard for inspection and supervision of the commercial banks and financial institutions licensed by the Bank. The Bank may, at any time, inspect and supervise or cause to inspect and supervise any of the offices of commercial banks or financial institutions. Such inspection and supervision may be carried out by the deputed official of the Bank or an expert designated by the Bank at the office of the commercial bank or financial institution or by asking the concerned institution to submit detailed particulars and information to the Bank itself.

It shall be the duty of the concerned commercial bank and financial institution or Directors, officials or employees of such commercial bank and financial institution to make available the statement, data, record, information, particulars necessary for computer and auditing and other programs and particulars developed through the electric system and financial control system or necessary other documents to such official, expert or the Bank or to enable such official or expert to review or to examine them within the time prescribed by such officer or expert.

The inspecting and supervising official or the Bank under this section may cause to record written statements of any Director, official or employee of the commercial banks or financial institutions with regard to the functions and proceedings which are deemed necessary in course of inspection and supervision.

The Bank or the inspecting and supervising official may issue necessary directives to the commercial bank or financial institution on the matters deemed necessary while inspecting and supervising. It shall be the duty of the concerned commercial bank or financial institution to abide by the directives issued by the Bank or by the inspecting or supervising official. The inspecting or supervising official shall inform the Bank as soon as possible about the directives so given.

The official or the expert who carries out inspection and supervision as per this Section shall have to submit the report of the inspection and supervision carried out by him/her to the Governor within the stipulated deadline.

The official or the expert who carries out inspection and supervision as per this Section shall have to submit the report of the inspection and supervision carried out by him/her to the Governor within the stipulated deadline. The Governor shall submit the report in the next meeting of the Board.

Commercial Bank and Financial Institution Deemed to be Problematic

Section 86A provides, Commercial bank or financial institution shall inform to the Bank within 15 days about the situation of insolvency or state of dissolution under the prevailing law or incapability to pay the debt or materially unable to discharge any or all liabilities by any commercial bank or financial institution.

Section 86B provides, the Bank shall declare any commercial bank or financial institution problematic by providing written notice to it when the Bank is convinced that the following conditions are prevailing in any commercial bank or financial institution on the basis of information received under Section 86A or from the report of inspection and supervision conducted under Section 84 or from any other means:

- In case any action against the interest of the depositors, shareholders, creditors, or general public is evident,
- In case of not fulfillment of any financial liabilities or not having probability to do that or not payment of due amount,
- In case of insolvency or going to be insolvent or facing material financial difficulties,
- In case of non-compliance with or breach of this Act, prevailing law related to bank and financial institution, other prevailing law, terms of license or regulation, directives or order of bank,
- In case it is evident that the license has been obtained on the basis of submitting false, fraudulent, wrong document or data,
- In case of inability to maintain the capital fund as per this Act, prevailing law related to BFI and directives issued by the Bank at time to time,
- In case of initiation of legal proceedings for liquidation/resolution/insolvency of any commercial BFI under the prevailing law,
- In case of undue delay in the process of voluntary liquidation where such proceeding has been initiated,
- For the commercial BFI established with the joint venture of the foreign commercial BFI, while such foreign commercial bank or financial institution is insolvent or liquidator is appointed for the liquidation or the license of such commercial bank or financial institution is terminated under the provision of the law of respective country or transaction is banned either fully or partially or where it is evident that operation of banking transaction is done in association with such commercial BFI,
- If the bank is convinced that commercial bank or financial institution is unable to pay its due or can make negative effect in its liability or duties, which it has to perform.

Action against Problematic Commercial Bank or Financial Institution

Section 86C (1) provides, notwithstanding anything contained in the Companies Act or other prevailing law, the Bank can take any or all of the following actions by taking up management of such commercial bank or financial institution under its control or against the Board of Directors of the commercial bank or financial institution concerned which is declared problematic under the provision of section 86B:

(a) To increase the paid up capital by issuing new shares or by receiving due amount of issued capital,

(b) To suspend the right to vote or other rights of shareholder,
(c) To stop payment of dividend or any other amount to the shareholders to increase the capital,
(d) To determine limitation to the amount of bonus, salary, compensation and other expenses for the director and other high level management officials,
(e) To make necessary arrangement for the corporate governance, internal control and risk management of commercial bank or financial institution,
(f) To prohibit or make limitation in collection of deposit, credit supply or investment,
(g) To maintain sufficient capital and high proportion of liquidity or prohibit business transaction or determination of other necessary terms,
(h) To limit transaction of the commercial bank or financial institution or prohibit sale of property or expansion of branch office or close any domestic or international branch,
(i) To maintain necessary arrangement for reduction of risk of the properties which are materially doubtful or securities without proper evaluation or other properties,
(j) To prohibit any action carried out illegally by breaching the prevailing law and regulation of the bank that is against the interest of commercial bank or financial institution,
(k) To prohibit from doing some specific business among the businesses allowed to commercial bank or financial institution for specific time,
(l) To receive prior approval of the bank for major capital expenditure, substantial commitments having major liabilities or for the expenditure of contingent liabilities,
(m) To issue order to remove from the post to single or more director or manager or employee as per the necessity,
(n) Nepal Rastra Bank may remove the director or manager or employee in case of not discharge of the order made under Clause (m) by respective commercial bank or financial institution,
(o) To suspend board of director of the commercial bank or financial institution and takeover the management of such commercial bank or financial institution in self-control or operate the management and transaction of such commercial bank or financial institution by appointed official,
(p) To order commercial bank or financial institution, which is listed in Stock Exchange for the application of de-listing,
(q) To prohibit payment of interest and principal for time bond auxiliary loan without having securities of commercial bank or financial institution,
(r) To take any other action as bank feels necessity and proper.

In case of control of any commercial bank or financial institution by the Bank under clause (o) of sub-section (1), the preliminary and annual report prepared by the Bank or the officer appointed by the Bank shall be submitted to the government of Nepal. Respective commercial bank or financial institution have to bear all the expenditure while the Bank takes the control of management of any commercial bank or financial institution and makes arrangement for the management and operation of transaction. Such order of Nepal Rastra Bank shall generally remain valid for two years from the date of issue unless it is not renewed by the bank.

The directors, managers, or employees removed by the Rastra Bank under clause (n) of sub-section (1) are not allowed to work or involve in transaction in the same commercial bank or

financial institution as director, manager or employee or any other post of any commercial bank or financial institution or any other way being involved directly or indirectly.

The directors, managers, or employees removed by the Bank under clause (n) or suspended member of board of directors under clause (o) of sub-section (1) are not allowed to receive or claim any remuneration or compensation under the provision of prevailing law or agreement held directly or indirectly from the date of such order.

Determination of the capital and valuation of assets and liabilities of any problematic commercial bank or financial institution shall be based on the basis, process and standard determined by the Bank.

Reformative Measures and Power of the Bank or the Official Appointed by the Bank

Section 86E provides, notwithstanding anything contained in the Companies Act or other prevailing law, the Rastra Bank itself or with the prior approval of the Rastra Bank, the official appointed by the Rastra Bank can initiate one or more of the following actions for the purpose of restructuring of any problematic commercial bank or financial institution which is under the control of the Bank by order issued under the provision of clause (o) of sub-section (1) of Section 86C:

(a) To cancel or suspend any transaction operating within or outside Nepal,
(b) To sell the assets of such commercial bank or financial institution to any other commercial bank or financial institution in terms and conditions determined by the bank,
(c) To terminate the employment of the employees working in such commercial bank or financial institution and to appoint new employees in their place as per necessity,
(d) To merge such commercial BFI with other commercial BFI or arrange to transfer the assets and liabilities of such commercial bank or financial institution partially or whole to any other commercial bank or financial institution or any other body,
(e) To increase the capital, being based on the standard determined by the bank, by selling the share to other person to reduce the participation of the present shareholders or to restructure such commercial bank or financial institution by reshuffling the board of directors,
(f) To reduce the capital reflecting the actual price of real assets of such commercial bank or financial institution under the provision of Section 86H and determine the face value of the shares in the proportion of reduced capital,
(g) To do necessary managerial restructure or corporate restructure by closing the branches and transactions which are not properly running for the protection of the interest of the depositors, shareholders, creditors and general public,
(h) To implement or cause to implement other measures determined by the Rastra Bank to make competitive for the problematic commercial bank or financial institution.

The reasonable opportunity of hearing shall be provided to any commercial bank or financial institution before taking any decision under (f) or (g) above. However, if the bank feels that prior opportunity of hearing can make negative effect to the interest of its depositors, shareholders, creditors or general public, the Bank can provide the opportunity of hearing as soon as possible after making such decision and if the Bank is satisfied with the reason and basis presented during the time of hearing, it can change or repeal the decision as per necessity.

Power of the Bank for Corrective Action

Section 86F Provides, the Bank has to publish in public the report of management auditing or auditing within one year of the control of the commercial bank or financial institution declared problematic under the provision of clause (o) of sub-section (1) of section 86C either conducted itself or by others.

Notwithstanding anything contained in the Companies Act or any other prevailing law, on the basis of the management auditing or auditing report, if Bank is convinced that the controlled commercial bank or financial institution can operate properly it can carry out following corrective actions as per necessity:

- Issue order to manage and operate the transaction to the board of director by releasing the suspension order issued under the provision of Clause (o) of sub-section (1) of section 86C,
- Assign the management and operation of transaction to the new board of director formed among the shareholders of such commercial bank and financial institution by removing suspended board of director under the provision of clause (o) of sub-section (1) of section 86C,
- Call or cause to call the general meeting of the shareholders of such commercial bank and financial institution to elect the new board of director for the management and operation of transaction after removing suspended board of director under the provision of clause (o) of sub-section (1) of section 86C, or
- Carry out any other corrective measures, which the bank thinks appropriate.

By remaining under the standard fixed on the ground of assessment of the management or audit report or the report of official appointed by the Bank, the Bank can give order as per necessary by publishing public notice for any shareholder to sell, distribute and transfer the ownership of the share remained in his/her name to any person deemed appropriate by the Bank so as to obtain payment of the price determined by the committee formed by getting the representatives of the Securities Board of Nepal and Institute of Chartered Accountants of Nepal as well as other external experts involved. The Bank can confiscate the shares which are not sold, distributed and transferred because of any reason, and the Bank can sell, distribute and transfer such share in any manner which it thinks proper to anybody with the advice of the committee.

Problematic Bank or Financial Institution May be Subject of Clearing and Settlement

While taking action upon any problematic commercial bank or financial institution as per section 86C or adopting reformative measure as per Section 86E or carrying out remedial work as per Section 86F as well, If the Bank believes in the matter that such commercial bank or financial institution is not able to fulfill the liability to be fulfilled or has fallen into the condition of not being able to operate properly, the Bank can take decision to subject such commercial bank or financial institution of the process of clearing and settlement under this Act.

Decreasing the Capital of Problematic Commercial Bank or Financial Institution

Section 86H provides, notwithstanding anything contained in the Companies Act or other prevailing law or memorandum of association and article of association of the problematic commercial bank or financial institution, after taking such commercial bank or financial

institution in its control under the provision of clause (o) of sub-section (1) of section 86C, in case there is reduction of the paid up capital of such commercial bank or financial institution or the due amount was not paid by the shareholders or liabilities is not recoverable by the assets of such commercial bank or financial institution, Bank can decrease the share capital of such commercial bank or financial institution in limit of reduction of the share capital or liabilities which is not coverable by the assets. However, before decrease of share capital, the Bank shall publish minimum two notice of this effect in national daily newspaper.

Before issuing the notice as above, the Bank has to provide 30 days' time for those shareholders who has due amount of the price of paid up share. Bank can initiate the process of cancellation of share of those shareholders who did not pay the due amount after such notice, and Bank can determine the minimum price for the share of the commercial bank or financial institution which is insolvent or in settlement process or in the process of dissolution.

In case of decrease of the share capital of any commercial bank or financial institution or cancellation of share, it shall be ipso facto considered that amendment in the memorandum of association and article of association of such commercial bank or financial institution is made accordingly.

Right to Appeal Against the Order of the Bank

Section 86I provides, only the representative of shareholders of the commercial bank or financial institution can appeal to the Board within fifteen days against the action, order, decision or proceedings of the Bank or the official appointed by the Bank, under Section 86C, 86D, 86E, 86F and 86H, if not satisfied with such action, order, decision or proceedings. Clarification: Here, "shareholders representative" means representative elected among the shareholders having minimum twenty five percent of prevailing share.

The Board shall not entertain appeal without having the representation of 25 % of prevailing shares. If the appeal is entertained, the Board may review or cancel the action, order, decision or proceedings done by the Bank or the official appointed by the Bank, within 30 days of receipt of such appeal by giving related proof, basis and reasons.

The action, order, decision or proceedings of the Bank or the official appointed by the Bank shall remain continue unless the Board cancels it. The decision of the committee on the appeal of the shareholders representative shall be final.

Establishment of Credit Information Center

The Bank shall establish or cause to establish one credit information Center for the following purposes:

- To obtain information on the flow of credit from commercial banks and financial institutions in order to ensure fairness and appropriateness in credit flow,
- To require the exchange of the information received pursuant to (a) amongst the commercial banks and financial institutions,

- To require to send the name list of the debtors not repaying the loan in time or misusing the loan to the Center,
- To require to obtain on compulsory basis the information from the Center prior to making investment or advancing loan of an amount more than the limit prescribed by the Bank,
- To have the name list received pursuant to (c) blacklisted by the Center upon confirmation and to take necessary action in this regard, and

To submit report to the Bank, on the exchange of information among commercial bank or financial institution and use such information while making loan investment on the basis of inspection, supervision and monitoring.

8 PROVISIONS RELATING TO RESOLUTION (SETTLEMENT)

Section 88A provides that the Bank may initiate the work of settlement by taking up any commercial bank or financial institution under its control on any of the following conditions:

- If its payment of liability cannot be made fully or partially,
- If there is condition of not being able to fulfill the liabilities to be paid, on the ground of supervisory analysis, within ninety days from the date of the completion of the work relating to such analysis,
- If liability exceeds the net assets,
- If sustained loss that cannot be covered up even by all kinds of capital and funds prescribed by the Bank,
- If the Bank makes decision to take to the process of resolution as per Section 86 G.

Only the bank shall have the power to carry out the settlement of the claim of the depositor and secured creditor remained upon any commercial bank or financial institution. Total expenses incurred while carrying out work relating to settlement of the commercial bank or financial institution shall have to be borne out of the amount received after selling out the properties of the commercial bank or financial institution concerned.

Formation of the Special Administration Team

If decision is made to initiate the work of resolution (settlement) of any commercial bank or financial institution as per Section 88 A, the Bank can initiate the work of resolution (settlement) by forming Special Administration Team comprising of maximum three persons from among the persons having qualifications as per prescribed for this purpose, and by taking up the concerned commercial bank or financial institution under its control.

If the work of all or any member of Special Administration Team is not satisfactory, the Bank can dismiss him/her from the post as per prescribed. Before dismissing him/her from the post, he/she shall have to be given the opportunity of hearing by being allowed reasonable time. If the Bank dismisses the member of the Special Administration Team before accomplishing the work relating to resolution (settlement), it can appoint another person having the qualification for that post as per prescribed. The remuneration of the member of Special Administration Team shall be as prescribed so as to be associated with work performance.

The power of the Directors, Chief Executive Officer and other officers of the commercial bank or financial institution, which is under the process of resolution, shall be held ipso facto suspended during the period of resolution. Special Administration Team can depute all or any of the Directors, Chief Executive Officer and other lien on posts for the work relating to resolution by releasing the suspension for the sake of carrying out works prescribed by it. It can dismiss the person at any time, who does not abide by the directives given to get deputed for the work as at any time. The person dismissed as above shall not obtain any remuneration and facility from such bank or financial institution.

Functions, Duties and Powers of Special Administration Team

Section 88C provides, Special Administration Team shall have the total power, which is allowed to be exercised by the general meeting, Board of Directors, Chief Executive Officer and other officers of the commercial bank or financial institution concerned.

The Special Administration Team shall have the following power regarding to manage the movable and immovable assets, to carry out resolution (settlement) of any property and liability of the commercial bank or financial institution concerned and to operate such commercial bank and financial institution:

- To sell all or partial share of the commercial bank or financial institution remained to be sold to new person,
- To allow any institution the responsibility to carry out operation of transaction and to carry out particular work that can be operated regularly with systematic perspective, or to establish separate bridge institution or unit for some period for the sake of carrying out such operation,
- To sell any or all transactions or properties of the commercial bank or financial institution concerned or any subsidiary company of such commercial bank or financial institution,
- To sell the properties or rights of the commercial bank or financial institution concerned, which remain under any other persons or institutions.

Regarding the commercial bank or financial institution remained under the process of resolution (settlement), Special Administration Team shall have other powers as follows:

- To get the documents, which the Special Administration Team deems necessary to further the act and action of resolution, submitted by the person concerned,
- To transfer, or get the ownership of the shares or other instruments issued by the commercial bank or financial institution concerned, transferred,
- To transfer certain power, properties or liabilities of the commercial bank or financial institution concerned to another person,
- To revoke the shares or other instruments issued by the commercial bank or financial institution concerned,
- To alienate the shares issued by the commercial bank or financial institution concerned or the shares or other ownership owned by any or all of its shareholders to the name of any other person on the ground as per prescribed,

- To issue preference shares or other instruments relating to capital,
- To move all the steps seen necessary to protect and take care of the properties of the commercial bank or financial institution concerned.

Special Administration Team does not need to carry out the following works while carrying out the work relating to resolution of the commercial bank or financial institution as per this section:

- To obtain prior approval of any persons of public or private sectors including the shareholders, depositors or creditors of the commercial bank or financial institution, which is under the process of resolution,
- To notify any person, firm, company or institution except mentioned otherwise in this Chapter.

Special Administration Team shall have to accomplish within one year of the commencement of the work relating to resolution as per this Act. However, if any work related to resolution being carried out by the Special Administration Team cannot be accomplished within the stipulated time, the Bank can extend the tenure of the Special Administration Team on the ground of necessity and justification.

Special Administration Team can carry out any or all of the following works on behalf of the commercial bank or financial institution concerned:

- To continue other works and actions being carried out by commercial bank or financial institution except for collecting the deposit and providing any credits,
- To postpone or halt any works and actions being carried out by the commercial bank or financial institution,
- To obtain loan by mortgaging or not mortgaging property of the commercial bank or financial institution,
- To prevent the payment of the liability of the commercial bank or financial institution or to determine limit for this,
- To appoint or dismiss the staff or the professional consultants necessary for the sake of commercial bank or financial institution,
- To summon assembly of the depositors and creditors for the purpose of holding discussion and making decision on the issue deemed necessary by the Special Administration Team,
- To make legal defense on the name of commercial bank or financial institution, or
- To carry out or get other necessary works related to resolution carried out.

If Special Administration Team deems appropriate to merge all or major property of the commercial bank or financial institution, which remains under its control, into any other commercial bank or finance company, or to merge into each other by acquiring the property of any other commercial bank or financial institution, application along with proposal regarding this shall have to be furnished to the Bank as per existing law. After receiving the application along with the proposal, the Bank shall have to make decision regarding accepting or refusing such application.

By preparing the account of the estimated expenses to be spent on the process of resolution out of the amount available on the ground of financial condition of the commercial bank or financial institution, and the amount that may be needed for the sake of other expenses as per existing law, management should be arranged to return or pay the amount for such liability at a time or on installment out of the amount that can be available to pay for the liability of the deposit that has been matured. While paying as such, the depositors and creditors of the same grade shall have to be treated equally.

The procedure relating to the determination of the validity of the claim laid by the depositor and creditor upon the commercial bank or financial institution concerned, payment of the claim, determination of liability and returning of the personal property of the client shall be as per prescribed. Notwithstanding whatever matter has been written in existing law, while selling the property of the commercial bank or financial institution, the Special Administration Team can sell by adopting transparent and professional perspective with more than one ways of auction, sealed bid, negotiation and so on, after determining minimum price on the ground prescribed.

Special Administration Team shall have to submit to the Bank, from time to time as per prescribed, the description along with the financial account of the commercial bank or financial institution, the plan of the sale of the property of such institution and its perspective regarding this, prior estimation of the liability of such institution or the mode of payment of this, actual transfer of the property and estimation of the liability.

If the Special Administration Team deems necessary to issue new share of the commercial bank or financial institution concerned, sell the property, unify the properties for the sake of securitization, to manage to make prior estimation of the liability or to manage such works, Special Administration Team can confer responsibility to anybody or company, which has been established to carry out works relating to the management of the property as per existing law, to carry out such works. It can also transfer power to such body or company to sell the passive credit, the property, which is hard to be evaluated, and liability of the commercial bank or financial institution concerned.

Preparation of New Balance Sheet

Special Administration Team shall have to prepare new balance sheet on the following grounds so as to reveal actual condition of the commercial bank or financial institution that is subjected to the process of the resolution (settlement) as per Section 88A:

- On the ground of the net price of the property to be obtained,
- By adjusting the price of the liability to be distributed on the ground of priority as per section 88 I.

While preparing new balance sheet, the method to determine liability shall be as prescribed. The balance sheet shall be submitted to the Bank as prescribed.

Recommendation for Improving Financial Condition of the Bank or Financial Institution

Section 88G provides, if it is seen that negative effect shall be incurred in overall financial stability or system while accomplishing the process of resolution (settlement) commenced regarding any commercial bank or financial institution as per this Chapter, Special Administration Team shall have to submit the report to the Bank, along with the steps to be moved in future by mentioning such description, including the condition of the properties and liability of such institution so as not to let such condition be created.

After receiving the report, if negative effect is seen to occur in entire financial stability and system while carrying out resolution of such commercial bank or financial institution by the Bank, and if it is seen that financial condition can be improved when the Government of Nepal invests in such commercial bank or financial institution, the Bank shall recommend such description, along with its opinion, to the Government of Nepal.

If financial condition of any commercial bank or financial institution is improved after investing by the Government of Nepal in such commercial bank or financial institution upon the recommendation of the Bank, Government of Nepal shall have to recover its investment within maximum of 5 years from the date of improvement by selling to the private sector through bid.

Sequence of Priority of Payment

Section 88I provides, after evaluating the amount received from the sale of the property of the commercial bank or financial institution remained under the process of settlement by depositor, creditor and Special Administration Team, the work of payment and allocating amount for the other persons shall have to be done on the ground of priority as follows:

(a) Necessary expenses incurred in the process of resolution including the expenses spent by the Bank and Special Administration Team for the sake of implementation of the provision of this Act, expenses for the remuneration and facility of the staff, fee of the professional employed for the work regarding this and other related expenses,
(b) The amount up to insurance security held as per existing law so as not to exceed the limit of the total claimed amount of the depositor or the amount equal to the payment if that has been made for the depositor by the institution established as per law that carries out insurance security,
(c) The deposit remained after payment as per (b),
(d) Approved claim of the persons valid as insured creditors as per law.

If the amount of approved claim of any grade is insufficient to be paid off while paying as per the above sequence of priority, the amount shall have to be proportionately distributed to the claimants of the equal grades. While paying to the depositors or secured creditors for the claim, payment should be made equally without discriminating on any ground such as nationality, place of domicile or jurisdiction.

The approved claim of the secured creditors, who submit claim on time, shall have to be paid, by keeping in the first priority, if the amount received from the sale of the property remained in

security covers up. The claim that is not covered up by such security shall be equal to the claim of other creditors.

Sub-section (5) provides, for the purpose of bearing liability relating to economic compensation that can be incurred as per sub-section (4) of section 88 L, Special Administration Team shall have to deposit 2 % amount out of the amount received from the sale of the property of such commercial bank or financial institution, by setting up separate account.

Sub-section (6) provides, the amount remained after allocating the amount as per sub-section (5) upon paying to the depositors and secured creditors, the tax, charge, fee to be paid and submitted as per existing law shall have to be proportionately distributed by the liquidator appointed as per sub-section (3) of Section 88 O to the other creditor or approved claimants and shareholders of that commercial bank or financial institution, or the persons having ownership by other ways on the ground of priority prescribed as per existing law.

Actions Commenced Prior to the Commencement of the Resolution to be Inactive

Special Administration Team may inactivate the transaction which affects in the properties of the commercial bank or financial institution or the transfer related to the third party in the following conditions:

- The transactions carried out or agreements forged before the commencement of the process of resolution so as to become against the welfare of the depositors or creditors of the commercial banks or financial institutions concerned,
- Any transfers made for any shareholders, Directors, lien on posts or their relatives by the commercial bank or financial institution without any price until before five years from the date of the commencement of the process of resolution,
- Any transfers made for any third party by the commercial bank or financial institution without any price before three years from the date of the commencement of the process of resolution,
- The transactions concluded in such a way of receiving lesser outcome by the commercial bank or financial institution or providing more outcome to the other party comparatively until before three years from the date of the commencement of the process of resolution,
- Any acts done so as to become against the welfare or affect the rights of the depositors of the commercial bank or financial institution until five years before, from the date of the commencement of the process of resolution,
- Transfer of property having on the name of creditor with the purpose of giving benefit to any person for the loan to be paid by the commercial bank or financial institution concerned or with the purpose to increase the amount to be received by the creditor in the process of liquidation until the six months before, from the date of the commencement of the process of resolution. However, the provision of this section shall not be attracted regarding the payment for the deposit made not exceeding the amount covered up by each deposit insurance and security.

Special Administration Team may revoke the transaction made with the director, officer of the commercial bank or financial institution or his/her close relative, till one year before the date of the commencement of the process of resolution, so as to become against the welfare of the depositor and the creditor of the institution, or can recover the amount for this.

The person who obtains property from the transaction or transfer as above shall have to return such property immediately. If the person, who has obtained the property, no longer possesses such property shall have to deposit the amount equal to the price of such property in the commercial bank or financial institution concerned. In connection to the person who carries out such transaction with any wrong intention, who does not immediately return the property or the price equal to it to the commercial bank or financial institution concerned after the transaction has been revoked, claim shall be fixed upon him/her as equal as the secured creditor.

In connection to any property, which has been unnaturally transferred to any person for less price from the commercial bank or the financial institution concerned, and which has been transferred to the third person even from such person, Special Administration Team can take it back by paying for investment cost of the third person.

While operating the process of resolution, Special Administration Team can send by writing to the body concerned to transfer any kind of movable or immovable property or rights. When the Special Administration Team sends by writing thus, the body concerned shall have to get such movable or immovable property or rights alienated or transferred on the name of the commercial bank or financial institution.

When Special Administration Team is on the process upon being formed for the sake of resolution for any commercial bank or financial institution, no one is supposed to interrupt or get other goods and service such as electricity, water, telephone, house and land, means of vehicle provided prior to this interrupted, simply because of not obtaining the amount for such goods and service. In connection to the payment for the goods and service obtained thus, Special Administration Team shall have to pay the service provider concerned with the arrears fixed before undertaking the process of resolution.

Final Description of the Work Relating to Resolution (Settlement)

After Special Administration Team concludes the work relating to resolution, or after the tenure of such Group is over, or within fifteen days of the dissolution of such Group due to any reason, it shall have to submit the report to the Bank, along with the description relating to the work and action accomplished by it and account of profit and loss of the commercial bank or financial institution concerned, source of financial transaction and its utility, after preparing and getting it tested, and including it as well. Necessary recommendation shall have to be included in such report regarding the steps to be moved in the future in the context of such bank or financial institution by the Bank.

After the report is received, the Bank shall have to make necessary decision, by considering including the recommendation mentioned in such report, on the issue of arranging the operation

of management as per Section 88 G or furnishing application to the court for the sake of liquidation of such commercial bank or financial institution as per Section 88O.

Application for Liquidation

Section 88O provides, if the process of settlement started by the Bank regarding any commercial bank or financial institution is concluded or if the Bank believes in the matter, on the ground of the recommendation furnished by Special Administration Team regarding this or on other grounds as well, before that process is concluded, that such commercial bank or financial institution cannot be properly operated, it can apply to the court for the sake of liquidating such commercial bank or financial institution.

When the Bank furnishes application for the sake of liquidation, sub-section (3) of section 10 and section 13 of Insolvency Act, 2063 shall not be applied regarding such commercial bank or financial institution. The court may give order to appoint liquidator for the sake of liquidation of such commercial bank or financial institution.

9 OFFENSES, PUNISHMENT & PROCEEDINGS

Section 95(1) describes, the following activities of a person shall be deemed to have committed offense under the Act:

- Whoever accepts deposits or gives credits or issues debenture or other financial instruments in contravention to this Act or the Rules or bye-law framed thereunder or an order or directive issued thereunder; or
- Whoever charges or gives interest against the policy determined by the Bank, or
- Whoever makes transaction of foreign exchange or is involved in such activities or instead of obtaining license from the Bank as per existing law, if transaction is made without obtaining it, or
- Obstruction is posed on the process of clearing and settlement under this Act.

Sub-section (2) provides, except otherwise provided under sub-section (1) any person who fail to comply with the provisions made under this Act or rules made thereunder, or bye-laws, or the order or directives issued thereunder, shall commit offence under this Act.

Penalty and Punishment

Section 96 has prescribed the following punishment for the offenses committed under section 95:

- The person who commits the crime as per sub-section (1) or (2) of section 95, fine up to three times of the property or imprisonment up to three years, or both the punishments shall be given by confiscating the property related to that crime.
- If there is the condition that the property cannot be fixed while punishing as per sub-section (1) or (2) of section 95, fine up to maximum of one million rupees or imprisonment up to three years, or both the punishments shall be given by looking into the extent of crime.

- If the crime as per section 95 is committed by any firm, company or institution, such punishment shall be given to the chief lien on post of such firm, company or institution.
- The person, firm, company or institution or the lien on post of such firm, company or institution who attempts to commit the crime as per section 95 or accomplices to commit such crime shall get half of the punishment which is given to the principal criminal.

The cases relating to the offences mentioned above shall be filed by Government of Nepal as plaintiff and such cases shall be deemed to have been incorporated in Schedule -1 of the Government Cases Act, 2049.

Fine for Violation of Bank's Regulation

Section 99 provides, in case any commercial bank or financial institution licensed under this Act, violates an order or directive issued by the Bank under this Act or under the regulation or Byelaws framed thereunder, the Bank may fine such commercial bank or financial institution an amount up to the amount related to such violation.

In cases where the Bank's regulation has been violated by a Director, official or employee of the commercial bank or financial institution, such fine shall be imposed on the concerned Director, official or employee.

Punishment for Violation of Bank's Regulation

Section 100 provides, in case any commercial bank or financial institution licensed from the Bank, violates an order or directive issued by the Bank under this Act or under the regulation or bye-laws framed thereunder, the Bank may impose one or more of the following punishment to such commercial bank or financial institution:

- Giving reprimand or written warning,
- Obtain an undertaking from Board of Directors for adopting reformative measures,
- Issuing written order to end up frequent violations, to abstain from such violation and to adopt reformative measures,
- Suspend or terminate the services of the Bank's employee,
- Prohibit commercial bank or financial institution to distribute dividend to its shareholders,
- Prohibit commercial bank or financial institution to accept deposits or to grant loan and advance,
- Imposing full or partial restriction on the transaction of business of the commercial bank or financial institution,
- Suspend or revoke license of the commercial bank or financial institution.

If a Director or official or employee of a licensed commercial bank or financial institution violates an order or directive issued by the Bank under this Act or under the regulation or bye-law framed there under or in cases where, they have acted against the interest of the depositor or general public or where they failed to submit the documents, particulars, data required by the

Bank or the inspecting or supervising official within the time prescribed, the Bank may impose the following punishments to such Director, official or employee:

- Giving reprimand or written admonition,
- Suspending,
- Imposing a cash fine not exceeding five hundred thousand rupees,
- Giving order to the Board of Directors of concerned commercial bank or financial institution to stop payment of all benefits including remuneration and allowances,
- Giving order to the Board of Directors of the concerned commercial BFI to remove Directors from his office of Director or to terminate the services of officer or employee.

Filing Appeal

The commercial bank or financial institution or the director or official or employee thereof not satisfied with the punishment imposed by the Bank under Sections 99 and 100 may file an appeal at the High Court within 35 days from the date of punishment.

10 MISCELLANEOUS

Accounting System, Annual Report and Auditing

The Bank shall have to keep the account of its profit and loss so as to reveal the transaction and financial condition as per account system according to Nepal accounting standards. International accounting standards shall have to be taken as basis on the sectors in which Nepal accounting standard is not involved.

The Bank shall prepare an annual report for each fiscal year, which should include the balance sheet, profit and loss and the particulars relating to it. It shall submit the annual report to Government of Nepal within four months from the date of completion of each fiscal year.

The Auditor General shall carry out auditing of the accounts of the Bank. The Board may, if it deems appropriate, cause the internal auditing of its accounts carried out by some external Auditor. While causing such auditing of accounts, it shall cause to be carried out in accordance with the account system of international practice.

Submission of Report to Government of Nepal and Report on Monetary Policy

The Bank shall prepare and publish its monthly balance sheet within 15 days of end of each month. The Bank shall have to submit the following reports to Government of Nepal within four months from the date of completion of each fiscal year:

- Auditing Report,
- Report on its activities of itself,
- Report on economic and financial position.

The Bank shall publish the report on monetary policy each year for the information of general public. The report shall contain the following matters:

- Comprehensive review and evaluation of the monetary policy introduced and followed by the Bank in the preceding year,
- Justification and analysis of monetary policy that the Bank is going to introduce in the following year.

Payment, Clearing and Settlement

The Bank shall make necessary arrangement for clearing and settlement of cheques, payment orders, interbank payment security transactions made in the currencies prescribed by the Bank and any other payment instrument & carry out functions of regulation, inspection and supervision thereof. The Bank may prescribe necessary procedures. For the purpose of clearing and settlement arrangement, the commercial bank or financial institution shall, subject to the terms and conditions prescribed by the Bank, open account in the Bank or any other financial institution prescribed by the Bank.

Trust Accounts

The Bank may open and operate separate account in the form of trust account for special purposes. The amount collected in such account shall not be used for any other purposes. The property in such account shall be used only for the purpose of fulfilling the liabilities of such accounts and the Bank shall not be allowed to use the amount or property in other accounts for fulfilling such liabilities.

Not to Work in Commercial Bank or Financial Institution

Section 106A provides, the person who has become a Governor shall not work in any commercial bank or financial institution by remaining in any status.

Deputy Governor and Executive Director of the Bank shall not work in any bank or financial institution by remaining in any status until 3 years from the date of acquittal (release) or retirement from his/her post. The staff of officer level of the Bank shall not work until two years from the date of acquittal or retirement from his/her post. After the expiry of the deadline, the Deputy Governor, Executive Director or Officer concerned shall have to obtain prior approval of the Bank for the sake of working in any commercial bank or financial institution by remaining in any status.

However, the above provision shall not be applied to the post in which the Government of Nepal makes appointment in any bank or financial institution.

Power to Frame Rules and Byelaws

In order to implement the objectives of this Act, the Bank shall, having obtained approval of Government of Nepal, frame necessary Rules on the following matters:

- Foreign Exchange Transaction,
- Refund of the burnt, torn, defaced or mutilated banknotes and coins,
- Transaction of business between Government of Nepal and the Bank, &
- Other necessary matters which Bank thinks necessary to implement objective of this Act.

In order to implement the objectives of this Act, the Board may frame byelaws on the following matters:

- The venue and time of the meeting of the Board and procedures relating thereto,
- Formation of sub-committees by the Board as per necessity and procedures of such sub-committees,
- Appointment, promotion, transfer, dismissal, remuneration, pension, gratuity, provident fund, leave, conduct, discipline, terms & conditions of service, of the employees of the Bank,
- Delegation of authority by the Board to the Governor, by the Governor to the Deputy Governor or other employees of the Bank,
- The terms and conditions for the lease agreements to be concluded on behalf of the Bank,
- The use of the seal of the Bank,
- The accounts, ledger, registrars, books and other record and documents to be maintained by the Bank and the format thereof,
- Internal auditing and inspection of the Bank,
- Supervision of commercial banks and financial institution,
- The particulars to be submitted by commercial banks and financial institutions,
- Cash deposit of the Bank or responsibility of the cash,
- The case to be filed on behalf of the Bank or operation of other transaction of business,
- Credit control,
- The Bank's system of expenditure,
- Regarding merging the commercial bank and financial institution or to be merged with one another,
- Regarding quick reformative action of the commercial banks and financial institutions,
- Regarding credit information,
- Regarding payment and account settlement,
- Regarding carrying out clearing and settlement,
- Regarding the license to be issued by the Bank,
- Other necessary subjects, which are necessary to implement the objective of this Act.

CHAPTER- 6

INDUSTRIAL ENTERPRISES ACT, 2076 (2020)

1. INTRODUCTION

Nepal being an agricultural country, it was felt that unless industries are developed providing employment to more people, the income level of the common people cannot be increased. Initially during the time Juddha Shumsher was the Prime Minister (1940-45); adjoining the Indian border industries like Biratnagar Jute Mills, Sri Raghupati Jute Mills, Juddha Match Factory, Bobbin & Plywood Factory, Morang Hydro Electric, etc. were established in Biratnagar Rani Area with a view to develop industries. But the facilities were adhoc as administered by the Ranas on case to case basis. In those days there was no income tax.

For the first time during the reign of King Mahendra, Industrial Enterprises Act, 2018 was passed with specific facilities for industries along with incentives for exports, facilities for foreign investors and creation of government owned companies. This Act of 2018 was replaced by Industrial Enterprises Act of 2030 which was again replaced by the Act of 2038. The Act of 2038 was substituted by the Act of 2049. This Act followed mostly the Industrial Policy evolved in 1987. The Act of 2049 was replaced by the Industrial Enterprises Act, 2073 (2016). This Act followed mostly Industrial Policy, 2067 of Government of Nepal.

Recently, the Act of 2073 has been repealed by the new Industrial Act, 2076. The date of authentication and publication of the Act is 2076/10/28. The Act moves towards regulating the industries in line with the existing three tiers of the federal structure (Federal, Provincial and Local government) (the "Industry Registration Body") and also segregates powers and authorities of each of them. There are certain changes in terms of industry registration process and registering authorities, in comparison to the Previous Act. The Act has been promulgated with the following objectives:

- To create the conducive Industrial Environment of the country,
- To increase national productivity and employment opportunities,
- To make optimum use of available resources of the country,
- To give emphasis to promote export by replacing the import through the means of industrial development,
- To make effective management of the industrial sector,
- To amend and consolidate existing laws on industrial enterprises.

In this Act, following terminologies are defined as follows:

(a) Industry Registration Body: ""Industry Registration Body" means the Department and the term also includes the Department or Office of Provincial Government responsible for administration of industries.
(b) Ministry: "Ministry" means Ministry of Industry of Government of Nepallooking after the matters related to industry
(c) Department: "Department" means the Department of Industry.
(d) Board: "Board" means the Industry and Investment Promotion Board constituted under Section 20.

Registration of Industries

Section 3 of the Act provides that no person shall cause to incorporate or operate any industry without registration under this Act. However, industries registered under previous Industrial enterprises Act shall not be required to register under this Act.

Sub-section (3) provides that industry established as branch industry before commencement of this Act, shall be required to be registered as separate industry by fulfilling the procedures under this Act within 1 year of commencement of this Act. If any industry desires to make its production or any part of its production from a location other than its original location or industry not desirous of registration as a separate industry within the time limit pursuant to sub-section (3), such branch industry may be operated by establishing as industry unit. While establishing unit as such, all the procedures except registration required for establishment of new industry under this Act, shall be required to be fulfilled. Further, such unit are required to keep a separate record of the production and transactions. Such record has to be circulated to the head office of the industry.

Section 4 of the Act provides provisions relating to application for registration of Industries. Any person, firm or company desirous of establishing following industries under this Act shall submit an application for registration to the Department in the prescribed form along with the documents and particulars as prescribed.

- Industry requiring permission as mentioned in Schedule-1,
- Industry established under foreign investment,
- Industry relating to subject (matter) falling under Annexure-5 of the constitution of Nepal,
- Industry having working jurisdiction of two or more Provinces,
- Industry related to educational consultancy service relating to diplomatic affairs.

Registration, renewal, regulation and other matters relating to administration of industries other than the industries to be registered in the Department shall be undertaken from the concerned Provincial Government. However, permission shall be required to be obtained in the case of industries requiring permission.Any person, firm or company desirous of establishing such industry, shall submit an application for registration to the Industry Registration Body of the concerned Province along with the documents and particulars as prescribed by the Provincial laws. Registration, renewal, regulation and other matters relating to industry administration of such industries shall be performed by the federal until legal provision relating to registration, renewal and regulation of the industries is made by the concerned Provincial Government.

The Act mandates certain industries (such as industry based on atomic energy, industries producing radioactive material, atomic energy and uranium energy related industries) which can only be established and operated by Government of Nepal.

The documents relating to registration of industry may be submitted online and may be certified through digital signature. On examination of application, if the required documents and information are incomplete, Industry Registration Body shall give immediate information to the applicant to provide such documents within maximum period of 90 days.

If the applicant does not submit the documents and information as such or failed to comply required formalities as required by this Act or Rules framed under this Act, the Industry Registration Body may refuse to register the industry with reasons thereof. If decision is made to refuse to register the industry as such, written information thereof shall be provided to the applicant along with the reasons within 5 days of such decision made.

The Act has provided some relaxations to micro enterprises for registration. In case of micro enterprises, application for registration of the industry can be submitted to the Industry Registration Body within 1 year of operation of such industry. The previous Act of 2073 allowed micro enterprises and cottage industry to file application for registration within 6 months from the date of its operation.

Section 5 of the Act provides that on receipt of the application for registration of Industry, the Industry registration Body shall, after making necessary examination regarding the compliance of required documents as per the Act and Regulation thereof, register the industry and issue registration certificate in the form as prescribed within 5 days from the date of receipt of documents. The Registration certificate shall contain the following matters:

- Date of issue of registration certificate,
- Duration within which the industry shall commence its commercial production or transaction,
- Terms & conditions to be abided by the industry,
- Other terms &conditions to be abided by the industry according to the nature of industry as prescribed by the Industry Registration Body as per nature.

Section 7 provides that after registration of industries, if it is required to conduct environment impact assessment or initial environmental examination pursuant to prevailing laws, establishment, operation, commercial production and commencement of transaction of such industries shall be carried only after approval of environment impact assessment or initial environmental examination report. Industries not required to conduct environment impact assessment or preliminary environment test shall mention the grounds for not conducting EIA or preliminary environment test while submitting application for industry registration and make self-declaration for adopting necessary measures to minimize unfavorable environmental impact caused in establishment or operation of the industry.

Appeal

Section 6 provides that if the Industry Registration Body refuses the registration of industry, the applicant not satisfied with the decision, may make an appeal to the Ministry of Industry in case of decision made by the Department and to the Ministry of the concerned Province looking industries in case decision is made by Industry Registration Body of the Province within 30 days from the receipt of issue of notice of refusal. The concerned appeal hearing authority has to decide the matter after necessary examination against the appeal within 30 days of receipt of application.

Requirement of Permission

Section 8 of the Act provides that permission is required from the Board for registration of industries prescribed in Schedule-1 of the Act. The Act further provides that permission of Council of Ministers, Government of Nepal shall be required before registration of industries mentioned in serial number 1 of Schedule-1 i.e., the Industries producing arms ammunitions, gun powder or explosive substances.

In the case of setting up industry requiring permission, application shall be made for permission in the prescribed form along with all particulars to the Board through the Industry Registration Body. On examination of application, if the Industry Registration Body is satisfied that all the prescribed documents and information have been received, it shall forward a report along with its opinion to the Board within 7 days for making necessary decision. Decision in this respect is required to be made by the Board within 30 days. If the decision of permission is made by the Board, the Industry Registration Body shall provide letter of permission to the concerned applicant within 5 days from the date of acknowledgement of the decision of the Board. On receipt of the permission, the application for registration of Industry is to be made within the time as specified in the permission letter. If application is not filed within the specified time, such permission letter shall *ipso facto* become ineffective.

The applicant obtaining permission for registration of industry shall not sell, transfer or change ownership before commencement of operation, commercial production or transaction of the industry. However, if any applicant dies before commencement of operation, commercial production or transaction of the industry, it shall not be hindrance (obstacle) for his/her legal heir pursuant to the prevailing laws, to complete the remaining work.

If the Board decides not to grant permission for the registration of industry, notice of refusal regarding permission shall be given by the Industry Registration Body to the applicant with 5 days from the date of decision made by the Board.

Information of Operation of Industry, Commercial Production or Transaction Commencement

Section 9 of the Act provides that an Industry registered under this Act shall commence its commercial production or operate industry or commence transaction within the period as mentioned in the registration certificate and provide the information to the Industry Registration Body within 30 days. If any industry is unable to commence its commercial production or operate Industry or commence transaction as mentioned in the registration certificate, it may apply to the Industry Registration Body for extension of the time limit with appropriate reason at least 30 days prior to the expiry of the time limit as mentioned in the industry registration certificate. Further, the Act also provides that if any industry is unable to make application within this time limit, it may apply to the Industry Registration Body for extension of the time limit within the period stipulated in the industry registration certificate, orwithin 6 months of expiry of the time period mentioned in the industry registration certificate by paying the late fees as prescribed.

On receipt of application for extension of time limit as above, if the reason is appropriate, the Industry Registration Body may grant extension of the time limit for commercial production or operate industry or commence transaction. However, if the duration for operation, commencement of commercial production or commencement of transaction of any industry is to be extended for more than 3 times, the Department shall apply to the Board along with its opinion for approval. If the time is extended, the concerned Industry shall commence commercial production or operate industry or commence transaction within the extended period.

If no application is made for the extension of time limit or failed to establish industry within the time limit or extended time limit, the registration certificate of such industry shall be *ipso facto* cancelled. If registration is cancelled as such, the Industry Registration Body shall record the reasons of such cancellation in the registration certificate of the concerned industry available in its record and shall also update in the industry registration register book.

If the period for operation of industry, commencement of commercial production or transaction cannot be extended, written information along with reasons shall be provided to the applicant within 7 working days. The registration certificate of such industry shall be *ipso facto* deemed to be ineffective.

Providing Returns

Section 13 of the Act provides that every Industry after commencement of commercial production or commencement of operation, shall submit particulars/returns as prescribed to the Industry Registration Body within 6 months of expiry of each fiscal year. The report may be submitted by electronic means. It further emphasizes that the return shall be submitted even if any industry is closed for more than one fiscal year or there is no production or transaction for any reason. It shall submit zero particulars for such period. However, if such industry provides information of closure of the industry to the Industry Registration Body and the matter is recorded in the register, returns for the period of closure of the industry shall not be required to be submitted.

Information Regarding Closure of Industry and Cancellation of Registration of Industry

Section 14 of the Act provides that if any Industry is to be closed due to any reason or commercial production or transaction is postponed, information of such closure or postpone shall be provided to the Industry Registration Body as prescribed within 30 days of such closure or postpone.

Registration cancellation of industry

Section 15 of the Act provides provisions relating to cancellation of registration of Industry. An application may be made to the Industry Registration Body in the form as prescribed along with the prescribed documents for cancellation of registration of Industry, if the industry cannot be operated due to any reason. However, that if it has become insolvent pursuant to prevailing laws, it shall be dealt according to the same law. On receipt of application, the Industry Registration Body after confirming that the taxes, government dues and all the liabilities of such Industry are

settled, shall cancel the registration of the Industry. It shall provide information of cancellation of registration to the concerned applicant and all concerned governmental agency.

In case of industries registered under companies undergo insolvency proceedings pursuant to the prevailing laws, it shall be according to the same law. If the industry is liquidated as such, the liquidator shall provide the information to the Industry Registration Body.

2 CLASSIFICATION OF INDUSTRIES AND FIXED CAPITAL

Classification of Industries

Section 17 of the Act provides about the classification of industries as follows:

1. General Classification (Classification on the Basis of Fixed Assets Investment):

Industries are classified as follows on the basis of investment in fixed assets:

(a) Micro Enterprises:

A micro enterprise means the industry having met the following conditions, except the industries requiring permission pursuant to section 8:

- Fixed capital is up to Rs. 20 lakhs except house or land,
  The entrepreneur is himself/herself engaged in management,
- There are up to nine workers including the entrepreneur,
- The annual transaction is less than Rs. 1 crore, and
- If an instrument with engine is used, the electric motor or other oil engine capacity has not to be more than twenty kilowatt.

(b) Cottage Industries:

Industries with following characteristics shall be deemed as Cottage industries:

- Traditional skill and technology based industries,
- Labour intensive and local resources and local technology and culture based industries
- If such industry has used engines, equipment or machines, energy used in such devices in the form of electricity shall not exceed 50 kilowatt,
- Industries prescribed in Schedule-2

(c) Small Industries:

It refers to the industries other than micro and cottage industries with fixed capital up to 15 crores.

(d) Medium Industries:

It refers to the industries with fixed capital of more than 15 crores and not exceeding 50 crores.

(e) Large Industries:

It refers to the industries with fixed capital of more than 50 crores.

2. Classification of Industries on the Basis of Products and Types of Services (Functional Classification):

Classification of industries as mentioned above, on the basis of products and types of services are as follows:

(a) Energy based Industry:

Industries engaged in energy production as mentioned in Schedule-3

(b) Manufacturing Industry:

Industries producing goods using raw materials, auxiliary raw materials, or semi-processed raw materials.

(c) Agro Forestry based Industry:

Industries based on agriculture or forest products or Industries prescribed in Schedule-4.

(d) Mineral Industry:

Industries producing mineral products other than metal or metallic mineral product through excavation or processing minerals thereof.

(e) Infrastructure Industry:

The industry that constructs and operates physical infrastructure as referred to in Schedule-5.

(f) Tourism Industry:

Industries related to tourism services as prescribed in Schedule-6.

(g) IT, Communication Technology & Information Transmission Technology based Industry:

Industries providing services of information, communication or information transmission having used technology for information collection, processing and transmission as referred to in Schedule-7.

(h) Service Oriented Industry:

Service production or service providing industries as referred in Schedule-8

If there is increment in capital or capacity, addition, alteration or change in objectives of any industry, the industry shall be *ipso facto* deemed to be re-classified as above. Government of Nepal may on the recommendation of the Board include any industry in the classification of industry or include industry of one class into another class by publishing a notice in the Nepal Gazette.

Fixed Capital of Industry

Section 17 of the Act provides thatfixed capital of an Industry shall consist of the following assets:

- Physical infrastructure constructed on land and underground, in space, water or under water,
- Physical infrastructures constructed above land (such as sewerage, internal road, drinking water, water supply system),
- Office, factory building or warehouse of industry,
- Residential building constructed for worker or employees,
- Electricity distribution and equipment & system related to it
- Machinery, equipment, tools and their reserved fittings,
- Means of transportation,
- Office tools and equipment of capital nature,
- Furnitureand fixture,
- Communication system and equipment & system related to it.

In addition to the assets referred above, the following expenses incurred before the establishment of industry or at the various stages of construction phases shall be included in the valuation of fixed capital of Industry:

- Technical and supervision expenses to be capitalized,
- Pre-investment and pre-operation expenses,
- Interest expenses to be capitalized,
- Environmental study and research cost incurred before the operation of the industry.

3 INDUSTRY AND INVESTMENT PROMOTION BOARD & ONE STOP SERVICE CENTER

Constitution of Industry and Investment Promotion Board

Section 20 of the Act provides that theGovernment of Nepal has formed an Industry and Investment Promotion Board as follows:

(a)	The Minister or State Minister forMinistry of Industries, Commerce and Supply	Chairperson
(a)	Member (looking after industries), National Planning Commission	Member
(b)	Governor, Nepal Rastra Bank	Member
(c)	Secretary, (looking after matters related to industries) Ministry of Industries, Commerce and Supply	Member
(d)	Secretary, Ministry of Finance	Member
(e)	Secretary, Ministry of Labor, Employment & Social Security	Member
(f)	Secretary, Ministry of Land Management, Cooperatives & Poverty Alleviation	Member
(g)	Secretary, Ministry of Forest & Environment	Member
(h)	Chief Executive Officer, Nepal Investment Board	Member
(i)	Joint Secretary, Industrial & Investment Promotion Division, Ministry of Industries, Commerce and Supply	Member
(j)	President, Federation of Nepal Chamber of Commerce & Industry	Member
(k)	President, Confederation of Nepalese Industries	Member
(l)	President, Federation of Nepal Cottage and Small Industries	Member
(m)	President, Federation of Women Entrepreneurs	Member

(n) ***Two*** persons including at least onewoman entrepreneur nominated by Ministry of Industries, Commerce and Supply from among experts in industrial sector Member
(o) Director General, Department of Industries Member Secretary

If both of the Minister and State Minister is appointed in the Ministry, the State Minister shall remain as member of the Board. The Board may, if it deems necessary, invite any expert or Officer of Government of Nepal or Provincial Government in the meeting of the Board. The meeting of the Board shall be held at least once in two months and may held at any time as per necessity. The member-secretary of the Board shall determine the agenda to be submitted in the meeting of the Board in consultation with the chairman and provide information to all the members at least 24 hours before holding meeting of the Board.

The member of the Board shall not be allowed to take part in the meeting of the Board in any discussion and decision in which personal interest of such member is involved. Any decision taken in violation of such norms shall be *ipso facto* void. The decision of the Board shall be authenticated and maintained by the member-secretary. The secretariat of the Board shall be situated at Department of Industries.

In addition to the other functions, duties and power mentioned in this Act, the function, duties and powers of the Board shall be as follows:

(a) To recommend to Government of Nepal for policy formulation and decision making on policies related to industrial promotion, investment security, enhancement and industrialization,
(b) To evaluate on a regular basis policy, legal, corporate and procedural structureand working system relating to overall industrialization of the country and recommend for its necessary reforms to Government of Nepal.
(c) To recommend to Government of Nepal for decision making on policy relating to foreign investment and technology transfer pursuant to the prevailing laws,
(d) To recommend to Government of Nepal for policy formulation and decision making relating to prevention of environmental pollution,
(e) To offer suggestion and recommendation to Government of Nepal to take required action after carrying out overall evaluation and review of industrial development status of the country;
(f) To solve or cause to solve the problem after hearing the complaint of industrialists and issue guidance to the concerned body,
(g) To recommend Government of Nepal for any change or alterationinrespect of level& classification and nature of the industries,
(h) To do or cause to do necessary study, research and survey relating to national or foreign investment increment in industrial sector,
(i) To carry out or cause to carry out necessary activities for constructing competitive industrial environment at effective, coordinative and harmonious cooperation of public, private and cooperative sectors,
(j) To provide guidelines and make arrangement for necessary coordination between the Province and Local Level for the development and diversification of industrial enterprises and make necessary provision of coordination,

(k) To resolve obstacles and confusions in respect of enforcement and implementation of industrial laws,
(l) To coordinate or facilitate relating to the operation of One Stop Service Center,
(m) To perform or cause to perform other functions as prescribed.

Provincial Industry & Investment Promotion Board

A Provincial Industry & Investment Promotion Board may be formed pursuant to the Provincial laws for the promotion of investment in industries registered and operating in the Provinces. The functions, duties and powers of the Provincial Industry & Investment Promotion Board shall be as follows:

(a) To evaluate on a regular basis overall Provincial industrialization promotion policy and make necessary recommendations to Provincial Government,
(b) To perform necessary functions relating to implementation of prevention of environmental pollution policy,
(c) To examine and evaluate overall position of industrial development of the Province and provide suggestions and recommendation to Provincial Government for necessary actions,
(d) To listen to the complaints of the entrepreneurs registered in the Province and resolve or cause to resolve problems or give direction to the concerned authorities,
(e) To do or cause to do necessary research or survey relating to increment of national investment in industrial sector of the Province,
(f) To do or cause to do necessary function with effective and coordinated performance between the public, private and cooperative sectors of the Province for the development of competitive industrial environment,
(g) To provide guidelines and make arrangement for necessary coordination between the Province and Local Level for the development and diversification of industrial enterprises,
(h) To issue direction to the concerned Provincial Ministry to write to the Ministry for resolving obstacles and confusions in respect of enforcement and implementation of any federal industrial laws,
(i) To coordinate with the Board through the Ministry relating to services and facilities available from One Stop Service Center,
(j) To perform or cause to perform other functions as prescribed relating to the promotion of the industries registered in Province.

The Provincial Industrial and Investment Promotion Board may make suggestions and recommendation to the Ministry through concerned Provincial Ministry on any matter deemed necessary for the industrial and investment promotion of the Province.

Establishment of One Stop Service Centre

Government of Nepal may, for the purpose of making available the services, incentive, exemption, facilities or concession to be enjoyed by any industry or the investor under this Act and other prevailing laws and in order to make available necessary services of different entities of Government of Nepal from one place on time and for providing administrative services like permission for registration of industry, registration, expansion and liquidation, constitute and operate One Stop Service Centre as prescribed.

The location of One Stop Service Centre, services to be provided to the industries through the Centre and representatives of entities to be stationed in the Centre shall be as prescribed. The concerned entities shall depute necessary employees as its representatives in the One Stop Service Centre. While deputing employees as such, the concerned authority shall delegate necessary powers as well.

Government of Nepal shall constitute One Stop Service Operation Committee as prescribed till the formation of One Stop Service Centre by publishing a notice in Nepal Gazette for making available the facilities and concessions to be enjoyed by any industry in time from a single place. The functions, duties and power of One Stop Service Centre shall be as follows:

(a) To perform functions relating to registration of company, firm or industry pursuant to prevailing laws, permission or license, renewal, approval for operation, industrial capacity increment and liquidation (other than insolvency) of company, firm or industry and functions related to administration of industries and enterprises,
(b) To perform functions related to approval of foreign investment pursuant to prevailing laws,
(c) To perform functions related to work permit and work agreementpursuant to prevailing laws,
(d) To perform functions related to visa facility pursuant to prevailing laws,
(e) To perform functions related to Initial Environmental Examination and Environmental Impact Assessment (EIA) pursuant to prevailing laws,
(f) To make necessary coordination with concerned entities for making available infrastructural services such as electricity, water, means of telecommunications, land, road, etc. required for the industries and to function as focal point with other entities.
(g) To implement or cause to implement the decisions made by Government of Nepal for making available the facilities and concessions to be enjoyed by any industry or investor pursuant to the prevailing laws,
(h) To perform functions relating to approval of foreign exchange pursuant to prevailing laws,
(i) To perform functions relating to providing of Permanent Account Number (PAN) pursuant to prevailing laws,
(j) To facilitate in the work relating to obtaining export, import identification number issued from Department of Commerce, Supply and Consumer rights protection and Department of Customs and facilitate in the work related to bonded warehouse.
(k) To perform such functions as may be delegated by the Board under its functions, duties and powers,
(l) To receive application and facilitate in providing approval for minerals necessary for the industries,
(m) To ascertain the documents required for registration of industries and receive in electronic form and develop and implement system for inter-entity transmission of documents,
(n) To make necessary coordination, and facilitation in acquiring land necessary for industries, assist in providing land on lease and make necessary coordination in availing land in excess of the ceiling,
(o) To give permission pursuant to prevailing laws or make recommendation for goods requiring import permission
(p) To establish and operate investment portal and provide notice and information relating to investment,

(q) To make every recommendations and facilitations necessary for industries,
(r) To implement or cause to implement the decisions or direction of Ministry and Board,

To perform other functions as prescribed by Government of Nepal by publishing notice in Nepal Gazette.

4 INCENTIVE, EXEMPTION, FACILITIES OR CONCESSIONS TO INDUSTRIES

Income Tax Exemption, Facilities or Concessions

Exemptions, facilities or concessions pursuant to the prevailing tax laws shall be available to industries registered under this Act. The industries shall be provided following exemptions, facilities and concessions:

Industries	Exemptions, Facilities & Concessions
Manufacturing Industries	20% exemption on the rate of tax imposed on the income earned from such industries.
Manufacturing Industries exporting goods or commodities produced	25% exemption on the rate of tax imposed on the income earned.
Industries investing in construction of roads, bridge, tunnel, Ropeway, Railway, Tram, Trolleybus, Airport, Industrial Structure and Infrastructural Complex and bringing such constructions into operation	40% exemption on the rate of tax imposed on the income earned from operation of such infrastructures.
Manufacturing industries except those producing fruits based cider, brandy or wine established in Under Developed, Undeveloped and least Developed Region	90%, 80% and 70% exemption respectively on rate of the income tax for up to 10 years from the date of commencement of commercial production or transaction.
Manufacturing industries producing fruit based cider, brandy or wine established in any Under Developed and Undeveloped Region	40% and 25% exemption respectively on the income tax for up to 10 years from the date of commencement of transaction.
Industries producing and processing domestic tea, dairy industries, industries producing textiles	50% exemption on the rate of tax imposed on the income earned from such industries.
Manufacturing or service industry set up with the investment of more than 1 billion rupees and providing direct employment to more than 500 individuals through out the year	▪ 100% income tax exemption for first five years from the date of commencement of business and 50% exemption on the income tax for next 3 years. ▪ Industries already in operation in case such industries enhance their installed capacity by at least 25%, increase capital to 2 billion rupees and provide direct employment to 300

	individuals through out the year shall be provided 100% income tax exemption for first five years for the income derived from enhanced capacity and 50% exemption on the income tax for next 3 years.
Individuals or entities obtaining approval to commercially generate, transmit or distribute hydro electricity by mid-April 2024 A.D. (Chaitra 2080 B.S.)	▪ 100% income tax exemption for first 10 years. ▪ 50% income tax exemption for next 5 years. ▪ Such exemption is entitled to Solar, Wind and Bio Mass energy as well. ▪ In case of industries that have already begun commercial production at the time of commencement of this Act, the exemptions applicable at the time of receiving approval would be applicable.
Industries conducting research and excavation of natural gas and fuel commercially, if commence the commercial transaction by mid April 2024 A.D. (Chaitra 2080 B.S.)	▪ 100% Income tax exemption for first 7 years from the date of commencement of transaction. ▪ 50% exemption on the income tax for next 3 years.
Industries relating to tourism sector established with the investment of above 2 billion rupees	▪ 100% Income tax exemption for the first 5 years from the date of commencement of commercial transaction. ▪ 50% exemption on rate of Income Tax for next 3 years.
Industries related to software development, data processing, cyber café and digital mapping established inside technology park, bio-tech park and information technology park specified by Government of Nepal by publishing notice in Nepal Gazette.	50% exemption on tax imposed on income of such industries.
Manufacturing Industries and Information and Communication Technology Industries employing 300 or more Nepalese through out the years	15% exemption on tax imposed on income of such industries for that year. (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees from among women, scheduled caste and disabled person)
Manufacturing Industries and Information and Communication Technology Industries employing 1200 or more Nepalese through out the year	25% exemption on tax imposed on income of such industries for that year. (Additional 15% exemption on income tax on that year in case the industry has 50% of its employees from among women, scheduled caste and disabled person)
Manufacturing Industries employing trainee employees equal to at least	Expenses incurred by industries for living expenses and training expenses during training of such

10% of its total employees	trainees and expenses incurred for development of its employees can be deducted for purpose of income tax.
Industries other than based on tobacco, liquor and casino	If such industries capitalize their retained earnings in extending their capacity or in the shares of other production based or energy based or agro-forestry based industry, dividend tax on distribution of dividend on such capitalization shall be exempted.
Cottage Industries and small industries with fixed capital up to 1 crore registered and operating at the time of commencement of this Act or registered and operating under this Act	50 % exemption on the income tax.
All Industries	▪ Expenses made by industries for long term welfare and benefit of employees or workers such as housing, life insurance, health facility, education and training, child care, sports etc. can be deducted for purpose of income tax. ▪ Expenses made for equipment & technology used to reduce or control the pollution or re-processing or reuse of wastages can be deducted up to 50% of the adjusted taxable income of the same fiscal year. In case the expenses cannot be deducted in full, the remaining amount is allowed to capitalize, the depreciation on which may be claimed in the subsequent fiscal years. ▪ Expenses incurred for the machine or equipment used for reducing power consumption can be deducted for the purpose of income tax. ▪ The costs incurred for increasing entrepreneurship, research and development and creation of new technology for enhancing the productivity of the industry can be deducted while calculating taxable income for an income year from business provided that such deduction does not exceed 50% of the adjusted taxable income from all business of the industry. In case the expenses cannot be deducted in full, the remaining amount is allowed to capitalize, the depreciation on which may be claimed in the subsequent fiscal years. ▪ Costs incurred in market promotion, survey and advertisement relating to the business can be deducted for the purpose of income tax. ▪ Costs incurred for the security of the physical

	assets as prescribed and actual premium paid for insurance can be deducted for the purpose of income tax. ▪ Costs incurred for the protection of industrial property under intellectual property registered in Nepal can be deducted for the purpose of income tax. ▪ Costs incurred for the registration fee paid to register the intellectual property in foreign country for its protection can be deducted for the purpose of income tax. ▪ 25% exemption on the rate of income tax on royalty received from export of intellectual property. ▪ 50% exemption on the rate of income tax on income earned from transfer or sale of intellectual property. ▪ Gifts or donations given to tax exempted organization can be deducted up to Rs. 100,000 or 5% of adjusted taxable income of the industry, whichever is less. ▪ Government of Nepal may by publishing notice in the Nepal Gazette, provide full or partial deductions for any prescribed expenses incurred or donations provided by any industry for the assessment of income.

Note:

i. *Industries based on tobacco and liquor are not entitled to any of the exemptions or facilities listed above. However, such industries may deduct actual expenses incurred in business promotion activities including long term welfare and benefit of employees or workers, in reducing or controlling pollution, re-processing of waste materials, in technologies and devices used reducing environment effects, in machine or equipment used for reducing power consumption, research and development expenses.*
ii. *In case an industry qualifies for more than one exemption in respect to similar income from among those listed above, the industry is only entitled to one exemption. Such industry is entitled to select the applicable exemption.*

Customs Duty Exemptions, Facilities & Concessions

The industries registered under this Act shall be provided exemptions, facilities and concessions on customs duty as follows:

Industries	Exemptions, Facilities & Concessions
Industries not having	If such industries export their products, Ministry of Finance

Bonded Warehouse or Passbook (cash deposit) facility	shall determine the rate of duty draw back and publish notice in Nepal Gazette. Ministry of Industry shall refund the amount of duty draw back calculated on the basis of such rate through One Point Service Center.
Industries not having Bonded Warehouse approval (exporting goods through prevailing banking channel or Letter of Credit or selling such goods in domestic market in convertible currency)	▪ Raw materials or auxiliary raw materials as well as packaging materials that are not produced in Nepal can be imported by furnishing the required guarantees under prescribed conditions and procedures. ▪ However, in case of packaging materials not produced in Nepal, recommendation of the Department is required to enjoy the benefit.
All industries	The Custom Duty levied in the import of such raw materials, auxiliary raw materials and packaging materials required for production shall be one level below the existing Custom Duty rate in import of finished goods using such materials.
All Industries	Custom duty is levied in the minimum rate on import of machinery, transformers, generators having capacity of 10 Kilowatt or more and other industrial devices imported by an industry for commercial purpose.
Quality assurance measuring laboratories	Custom Duty is levied in the minimum rate for the import of machinery and scientific devices that are being imported to ensure quality as well as such machinery and equipment imported by industries for research and development.
Industries manufacturing intermediate goods	Custom duty paid by the industries on import of raw material (used in production of export goods) shall be refunded to the industry manufacturing intermediate goods on the basis of quantity of exported goods. However, such amount shall not be refunded if application for refund is not submitted within 1 year of export.

Other Exemption and Facilities for Micro Industries

Notwithstanding anything mentioned in prevailing laws, no fees or charges shall be levied on registration of micro enterprises pursuant to this Act. Micro Enterprise already in operation at the time of commencement of this Act and Micro Enterprises registered and operating pursuant to this Act shall be entitled to 100% income tax exemption.

Additional Facilities Available to Women Entrepreneur

Industries registered under the ownership of Female Entrepreneurs only are entitled to the following additional facilities and concessions:

- 35 % exemption in existing industry registration fees.
- 20% exemption in existing rate of registration of industrial property used by the industries.
- If any female entrepreneur desires to establish new industry inside any industrial area and industrial village, the authority operating such area shall give priority in providing space.

- In case such industry require loan for exporting produced goods, export loan as prescribed may be provided to the industry through banking system from Women Entrepreneurs Loan Fund on the basis of financial transaction of the industry.

Additional Facilities & Concessions

In addition to the exemptions, facilities and concessions provided above, the following industries may be provided additional facilities and concessions as follows:

- Industries based on forest products can be given possessory right pursuant to existing laws over forest in any region through lease or other promissory guarantee under prescribed conditions.
- No fees or royalty pursuant to the existing laws shall be applicable in electricity produced by industry for its own consumption.
- Such industry willing to sell surplus electricity to any other industry, may sell so pursuant to existing laws in the rate agreed upon by both parties.
- Government of Nepal may provide additional exemptions and facilities to export based industries and prescribed industries established inside Special Economic Zone or inside government or private industrial estate by publishing notice in Nepal Gazette.
- Government of Nepal may provide additional exemptions and facilities by publishing a notice in Nepal Gazette to National Priority Industries or industry making optimum use of domestic raw materials, labor or skill or industries established by inventing technology or goods inside Nepal upon recommendation of the Board.
- Government of Nepal may provide exemptions in demand charge added in electricity cost under prescribed conditions and procedures.
- Government of Nepal may provide aid assistance as seed capital to cooperatives, micro enterprise, small and cottage industries to establish industries inside Under Developed Region under prescribed conditions.
- Industries operating under Foreign Investment may be given approval to import goods produced by the parent company located in foreign country for production, market development and promotion of new goods for a prescribed period under prescribed terms and conditions.
- Government of Nepal may provide exemptions, facilities and concessions as prescribed to the production based industries, agro-forestry based industries and mineral industries pursuant to section 17(2) other than industries based on tobacco and alcohol.
- Exemptions may be provided on custom duty levied on import of necessary machinery, tools, equipment and new technology by micro, cottage and small industries required for its capacity increment.
- Government of Nepal may make special provisions relating to exemptions, facilities and concessions to industries operating at Economic Zone, Product Specific Zone and Industrial 'Gram'.
- Government of Nepal may provide additional exemptions, facilities and concessions to industries situated at under developed, undeveloped and least developed region.

Provisions Relating to Land, Land on Lease & Maximum Land Threshold

Section 30 provides that industry registered under this Act or pursuant to prevailing laws has to purchase such land as may be required for the industry by the entrepreneur his/herself. However, if the entrepreneur operating prescribed industry is unable to purchase the necessary land for the operation of the industry and makes a request, setting out the content, for the purchase or availing the land, the Industry Registration Body shall make necessary recommendation, coordination and facilitation for that purpose.

The Act has introduced provision on providing land on lease to the industry. If it is necessary to avail land owned by Government of Nepal to operate national priority industries, such industry may specifying the area of land required for it, make application as prescribed to the Industry Registration Body for availing such land. The Industry Registration Body shall forward the application to the Ministry for availing required land to the Industry. Government of Nepal may provide such land on lease pursuant to the prevailing laws to the concerned industry for the operation of the Industry.

The amount to be paid by the industry and other conditions relating to the lease for the land provided on lease shall be as mentioned in the agreement between the Government of Nepal and concerned industry. If any industry operating by obtaining land on lease pursuant to this section, cannot operate due to any reason, the lease agreement shall be ipso facto cancelled and Government of Nepal shall get back such land with any condition.

The Act has also introduced provision on exemption of maximum threshold of land required for the industry. Section 32 provides that if land required for any industry is in excess of the ceiling permitted to be hold pursuant to the prevailing laws, the concerned industry may file an application to the Industry Registration Body for holding such excess land. The Industry Registration Body shall make necessary examinations on the application and submit report along with recommendation to the Ministry. On receipt of the application, the Ministry may provide exemption to hold land in excess of the ceiling if deemed necessary. The land in excess of the ceiling shall be used only for the same purpose for which it has been exempted.

The Industry Registration Body shall monitor or cause to monitor as prescribed whether or not the industry has used the excess exempted land for the approved purpose and may issue necessary direction. If it is found that the Industry has not abided the directives issued by the Industry Registration Body as above, Government of Nepal may get back such land in excess of the ceiling without any condition pursuant to the prevailing laws.

The industry which has obtained permission to hold land in excess of the ceiling pursuant to the prevailing laws, shall not be allowed to sell, transfer or extinguish right in any manner or keep such excess land as collateral in bank or financial institution to obtain credit.

The maximum ceiling of land hold by industry on the basis of requirement, authorized capital and nature of industry, provision relating to availing land in excess of the and the terms and conditions relating to it to be abided by the industry shall be as prescribed pursuant to the prevailing laws on land.

5 PUNISHMENT AND APPEAL

Provision Relating to Punishment

The Act has focused on broader scope of offenses as compared to the previous industrial laws. Section 30 of the Act provides that it has laid down punishment as follows:

(a) If it is found that any person operates industry without registration pursuant to sub-section (3), the Ministry may on the recommendation of Industry Registration Body cause to close down such industry and may impose following fines:

(i) Micro Enterprise:	Rs. 5,000
(ii) Cottage & Small Industries:	Rs. 25,000
(iii) Medium Industries:	Rs. 50,000
(iv) Large Industries:	Rs. 100,000

(b) If any industry carries activities against its objectives, the Ministry may on the recommendation of Industry Registration Body impose following fines:

(i) Micro Enterprise:	up to Rs. 2,000
(ii) Cottage & Small Industries:	up to Rs. 50,000
(iii) Medium Industries:	up to Rs. 100,000
(iv) Large Industries:	up to Rs. 500,000

(c) If any industry does not provide information of operation of industry or commercial production or commencement of transaction within the time prescribed pursuant to section 9 (within 30 days), the Ministry shall on the recommendation of Industry Registration Body impose following fines:

(i) Micro Enterprise:	Rs. 2,000 for every 6 months
(ii) Cottage & Small Industries:	Rs. 10,000 for every 6 months
(iii) Medium & Large Industries:	Rs. 25,000 for every 6 months

(d) If any industry relocates industry without obtaining permission pursuant to section 11 or increases capital or capacity or amends objectives without obtaining permission pursuant to section 12, the Ministry may on the recommendation of Industry Registration Body impose following fines:

Micro Enterprise:	Rs. 5,000
Cottage & Small Industries:	Rs. 25,000 to 50,000
Medium & Large Industries:	Rs. 100,000 to 300,000

Industries requiring permission pursuant to section 8: 100 % additional fines levied pursuant to (ii) & (iii)

(e) If any industry does not provide prescribed information within the time prescribed pursuant to section 13 (within 6 months of expiry of fiscal year), the Industry Registration Body may impose following fines:

(i) Micro Enterprise:	Rs. 1,000
(ii) Cottage & Small Industries:	Rs. 5,000

(iii) Medium Industries: Rs. 10,000
(iv) Large Industries: Rs. 25,000

(f) If any industry misuses the exemptions, facilities and concessions pursuant to section 36, the Ministry may on the recommendation of Industry Registration Body take following actions:
- Not to provide the exemptions, facilities or concessions under this Act, if facilities yet to be provided,
- Recover such amount if facilities are already utilized or fine equivalent to the amount of facilities utilized.

(g) If any industry does not undertake Corporate Social Responsibility (CSR) pursuant to section 54, the Ministry may on the recommendation of Industry Registration Body impose following fines:
- Amount equivalent to 1.5 % of annual net profit of such industry.
- Additional fine equivalent to 0.5% of annual net profit for each fiscal year to the industry which has not undertaken CSR responsibility for more than one fiscal year.

(h) If any industry does not abide the conditions prescribed by this Act or the Rules framed under this Act or the directives issued by the Ministry on the recommendation of the Industry Registration Body from time to time, the Industry Registration Body may impose following fines:

(i) Micro Enterprise: up to Rs. 5,000
(ii) Cottage & Small Industries: Rs. 50,000 to 150,000
(iii) Medium Industries: Rs. 150,000 to 300,000
(iv) Large Industries: Rs. 250,000 to 300,000

(i) If any industry violates any of the provisions of this Act or the Rules framed under this Act other than the provisions mentioned in this section, the Ministry may on the recommendation of Industry Registration Body impose following fines:

(i) Micro Enterprise: up to Rs. 15,000
(ii) Cottage & Small Industries: Rs. 15,000 to 30,000
(iii) Medium Industries: Rs. 30,000 to 50,000
(iv) Large Industries: Rs. 50,000 to 100,000

Additional fine of 50 % shall be imposed to any industry requiring permission pursuant to section 8 while imposing fines pursuant to this section. The section further provides that provisions relating to fines and punishment to industries registered or regulated from Province or Local Level shall be as determined by the concerned Provincial or Local laws.

Appeal against the order of decision made under this chapter can be filled in the High Court within 35 days of knowledge of punishment. Appeal may be filled in the concerned District Court with respect to the decision made by Industry Registration Body at Local Level and in the concerned High Court with respect to the decision made by the Provincial Industry Registration Body or the Department.

6 MISCELLANEOUS

Provision Relating to Sick Industry

Section 39 of the Act provides that if any Industry is being operated for a minimum period of five years after commencement of its commercial production or transaction and its production level is thirty percent or less than thirty percent of the total production capacity in the last 3 consecutive years owing to the circumstances beyond control without any default or weakness on the part of the management and operating in loss for a consecutive period of such 3 years, Government of Nepal may, on the basis of prescribed criteria and following the prescribed procedures declare it as a sick industry. On the basis of identification of the sick industry, it may be classified as fully sick industry, sick industry and sick oriented industry on the prescribed grounds for its appropriate management.

If the industry which is in the state of closure owing to sick, seems from the schemes or project proposal submitted by the industry or study conducted by the Ministry, that it can be re-operated by providing certain exemptions, facilities or concessions, Government of Nepal may provide facilities, exemptions and concessions as prescribed for the resurgence, reconstruction and management of such industries for certain period.

If any Cooperative society along with the participation of investors submits proposal for the operation of the sick industry, the industry may, based on the capacity and feasibility of the Cooperative society, be operated by such Cooperatives society within the prescribed conditions.

Notwithstanding anything mentioned in the prevailing laws, Government of Nepal may provide full or partial rebate on duty, fees or taxes levied on machineries, tools or equipment imported for expansion, restructuring or diversification of sick industry.

National Priority Industries

Industries as mentioned in Schedule- IX of the Act shall be included in National Priority Industries. The details of the list is provided in the Schedule.

Industrial Manpower

Section 49 of the Act provides that human resources required for the industry shall have to be fulfilled from Nepalese citizens. However, the Act has also provided some relaxations for hiring foreign citizens. Accordingly, if Nepalese citizen could not be available for any skilled technical post or for senior level management post, even after publishing an advertisement in national level newspapers, foreign nationals may be hired by such industry for a maximum period of 5 years after obtaining work permit pursuant to the prevailing laws upon the recommendation of the Department of Industry. Before making recommendation, the Department of Industry shall consider the following matters:

(a) Whether the Industry had attempted or not to appoint such human resource from Nepali citizens,
(b) Whether or not there is requirement of such skilled human resource,
(c) Whether or not such human resource are available in Nepal.

If a person so appointed happens to be a technician of special category but not available within Nepal, such person may be appointed for up to an additional period of 2 years by obtaining work permit as above.

A foreign national who is working in any industry as above, he/she may repatriate outside Nepal, amount not exceeding 70 % of his/her remuneration in convertible foreign currency.

Industry & Investment Promotion Fund

Section 51 of the Act provides that Government of Nepal shall establish an Industry & Investment Promotion Fund for promotion and preservation of industrial investment of the country. The following amounts shall be credited to the Fund:

- Amount received from Government of Nepal,
- Amount received from domestic organizations, institutions or person,
- Amount of income earned from investment or balance amount available in Micro, cottage and Small Industries Development Fund, Venture Capital Fund, Technology Development Fund, Industrial Investment preservation and promotion Fund, Sick Industries revival, reconstruction and management fund, Women entrepreneurship development fund, effective at the time of commencement of this Act.
- Amount received as bilateral or multilateral grant or assistance from foreign government, international associations and institutions. However, permission of Ministry of Finance, Government of Nepal shall be required to be obtained before receiving grant or assistance from foreign government or international associations and institutions.

The amount of the Fund may be spent in the following work on the basis of approved annual program of the Fund:

- Development of micro enterprises, cottage and small industries,
- Technology development,
- Industrial promotion,
- Resurgence, reconstruction and management of sick industry,
- Women entrepreneurship development.

Provincial Government may establish a Provincial Industry & Investment Promotion Fund for promotion and preservation of industrial investment of the Provinces. The operation and management of the Fund shall be pursuant to the Provincial laws. The amount of the Fund may be spent for the purpose as mentioned above.

Corporate Social Responsibility

Section 54 of the Act provides that Medium, large industries, or cottage and small industries with annual turnover of more than 15 crores shall allocate at least 1% of the annual net profit of each fiscal year to be utilized towards corporate social responsibility.The fund created for corporate social responsibility is to be utilized on the basis of annual plans and programs in the prescribed sector. Industries shall submit report of programs completed in each fiscal year and the amount spent for such program to the relevant Industry Registration Body within 6 months of

expiry of the fiscal year. The amount allocated for corporate social responsibility shall be entitled to deductas expense for the purpose of income tax.

Local Level May Perform Function Relating to Industry Administration

Local Level may perform functions of registration, administration or regulation of micro enterprises and cottage and small industry having fixed capital up to the limit prescribed in Provincial laws, pursuant to the provisions of federal and provincial laws.

Prohibition on Construction of Residential Building in Industrial Area

Section 506 of the Act provides that after the commencement of this Act, residential house or residential society shall not be constructed or developed within such area and distance of industrial zone, industrial village and special economic zone as prescribed by Government of Nepal by publication of notice in Nepal Gazette. If any person incurs loss due to the restrictive provisions as mentioned above, Government of Nepal shall provide reasonable compensation to the concerned person within the prescribed time by fulfilling the procedures as prescribed.

Declaration of Industrial Village, Industrial Cluster, Industrial Zone, Special Economic Zone

Section 54 of the Act provides that Government of Nepal, may declare any place or area in Nepal as industrial village, industrial cluster, industrial zone, special economic zone or industrial corridor for the proper management and operation of the industries by publishing notice in the Nepal Gazette.

(Students Note: Government of Nepal framed Industrial Enterprises Rules, 2076 by virtue of the powers conferred to it pursuant to section 55 of then Industrial Enterprises Act, 2073. Now the Industrial Enterprises Act, 2073 has been repealed by the Industrial Enterprises Act, 2076. Hence, provisions of Industrial Enterprises Rules, 2076 are not taken for effect in this Act.)

SCHEDULES RELATING TO THE ACT

SCHEDULE– 1

(Related to section 8)

Industries Requiring Permission

1. Industries producing arms ammunitions, gun powder or explosive substances,
2. Security printing, currencies and coins producing industries,
3. Industries producing, cigarette, *Biri, Khaini,* cigar and other products having tobacco as the main raw material or electric cigarette,
4. Industries manufacturing micro brewery, beer, liquor or liquor based products,
5. Stone, concrete and sand extraction and processing industries,
6. Industries manufacturing radio and telecommunication equipment,
7. Industries involved in mining of precious minerals and petroleum products,
8. Industries refiling liquefied petroleum gas (LPG)
9. Industries manufacturing drones or industries providing services through drones,
10. Other industries requiring permission pursuant to prevailing laws.

SCHEDULE– 2

[Related to clause (b) of sub-section (1) of section 17]

Cottage Industries

1. Hand looms, paddle looms, semi-automatic looms, fabric wrapping; dyeing, printing, sewing (except readymade garment) and weaving through traditional technology,
2. Hand woven radi, pakhi, carpet, pashmina, and dress based on wool and silk, handmade paper and goods based on it,
3. Filigree and ornamental items based on traditional crafts,
4. Traditional sculpture,
5. Handmade utensils and handicrafts made of copper, brass, dhalot, kaash, and German silver,
6. Handmade utensils made of iron and items of home use such as knifes, chulesi, sickle and spade and so on,
7. Handmade ornaments made of gold and silver, utensils (including valuable, semi-valuable goods, utensils and normal stone fitted),
8. Stone-cutting industries (precious, semi-precious and ordinary stones available in the country), handmade goods made of rural tanning/leather,
9. Industries based on natural fiber including jute, sawai grass, bamboo fiber, grass, cotton threads, etc.
10. Stone-art (goods made from stone carving),
11. Pauva, thanka art and other traditional fine art,
12. Masks and dolls and toys demonstrating traditional culture,
13. Various handicraft items demonstrating traditional culture, musical instruments, and arts,
14. Decorative items made of wood, bone, horn, clay, stone and artistic goods made from minerals, Ceramics and clay pots,
15. Hand printed Brick Industries.

SCHEDULE– 3

[Related to clause (a) of sub-section (2) of section 17] **Energy Based Industries**

1. Industries producing energy from hydro sources, wind, solar energy, coal, natural oil and fuel or gas, biomass or other sources. Industry manufacturing machine/equipment used in production of such energy,
2. Electricity transmission line,
3. Electricity distribution system,
4. Energy based on biogas,
5. Electricity energy produced in the form of joint production of sugar industry,
6. Feasibility study of energy

SCHEDULE– 4

[Related to clause (c) of sub-section (2) of section 17]

Industries based on Agriculture and Forest products

1. Horticulture/fruits processing,
2. Food processing,
3. Animal husbandry, animal breeding,
4. Dairy Industries (including dairy products),

5. Hatchery/chickens breeding,
6. Fisheries/fish breeding,
7. Sericulture farming and silk processing,
8. Tea estate/tea processing,
9. Coffee farming/coffee processing,
10. Herbs farming/herbs processing,
11. Production of vegetable seeds,
12. Vegetables farming/vegetable processing,
13. Establishment and operation of green houses,
14. Bee-keeping (including honey production and processing),
15. Floriculture (including preparing a garland, decoration, making bucket, and seeds production),
16. Nursery enterprise, establishment and management of botanical garden, botanical reproduction enterprises (inclu/ding tissue culture)
17. Rubber farming and preliminary processing of rubber,
18. Cold storage, agriculture market operation and management,
19. Establishment and management of cooperative/leasehold/community/private forests,
20. Commercial farming and processing of cash crops (such as sugarcane, cotton, jute, sajiwan, sweet sorghum, tobacco, cardamom, ginger, keshar, oil seeds, and spices crops, pulses and so on),
21. Rattan, bamboo farming and products from rattan and bamboo,
22. Seed processing,
23. Saw mill, furniture industry
24. Parquetting, seasoning, treatment plant, plywood, composite, wood based board industries,
25. Paper, resin and other non-wood based forestry industry,
26. Mushroom, tissue culture, agro forest,
27. Cotton farming, production and processing of cotton and cotton seed.

SCHEDULE– 5

[Related to clause (e) of sub-section (2) of section 17]

Infrastructure Industries

1. Roads, bridges, tunnels,
2. Ropeways, railways, tram, trolley bus, cable car, monorail, sliding car,
3. Airport runways/airports,
4. Industrial structure and infrastructure complex,
5. Convention, conference halls,
6. Water supply and distribution,
7. Irrigation infrastructure,
8. Sport complex and stadium,
9. Vehicles parking place and parking houses,
10. Export processing Zones,
11. Special Economic Zones,
12. Cargo complex,
13. Waste water treatment plant,

14. Telephone tower, optical fiber network, satellite, satellite transmission lines,
15. Home and residential building,
16. Film city construction, film studio construction,
17. Commercial complex,
18. Private warehouse,
19. Construction, management and operation of infrastructure for installation of fuel and gas supply line,
20. Energy house and construction, management and operation of infrastructure of energy transmission line.

SCHEDULE– 6

[Related to clause (f) of sub-section (2) of section 17]

Tourism Industries

1. Tourists residence, motel, hotel, resort, and restaurants,
2. Travel agency, tour operator, tourist guide, healing centers, casino, massage, spa,
3. Adventure tourism: Trekking, skiing, paragliding, water rafting, hot air ballooning, para sailing, horse riding, elephant riding, bunjee jumping, mountain climbing, ultra-light, sky driving,
4. Cable car construction and operating industries,
5. Golf course, polo, pony trekking, trekking, cycling,
6. Village tourism, homestay, eco-tourism and agriculture tourism,
7. Cultural, religious, conference and sports tourism,
8. Fun park, water park
9. Wildlife conservation,
10. Museum

Schedule-7

[Related to clause (g) of sub-section (2) of section 17]

Industry based on Information Technology, Communication Technology and Information Dissemination

Part A: Information Technology Industries

1. Technology parks,
2. IT parks,
3. Biotech parks,
4. Software development,
5. Computer and allied services,
6. Statistics processing,
7. Cyber café,
8. Digital mapping,
9. Business Processing Outsourcing (BPO), Knowledge Processing Outsourcing (KPO),
10. Data center, data mining, cloud computing,
11. Digital signature certifying agency,
12. Web portal, web design service, web hosting, online classified advertisement service.

Part B: Communication Technology Based Industries

1. Internet service provider,
2. Telephone, cellular telephone, mobile satellite phone service operator,
3. Teleport service,
4. Satellite establishment and operation, Satellite transmission center establishment, V-sat service,
5. Broadband infrastructure, telecom tower, optical network, satellite network,
6. Social media, online message, video call, conference.

Part C: Transmission Based Industries

1. FM radio, digital radio broadcasting,
2. Television broadcasting services (satellite and cable television broadcasting),
3. IPTV, Online service,
4. Digital cable TV network, direct to home satellite service, MMDS network,
5. Recording studio, transmission studio,
6. Print media industries, audio video instrument manufacturing industries, advertisement industries,
7. Film and telefilm production.

Schedule-8

[Related to clause (h) of sub-section (2) of section 17]

Service-oriented Industry

1. Workshop
2. Printing press and service related to printing
3. Professional research and development, management, engineering and design, legal, account, audit, education training, educational and technical consultancy services,
4. Ginning and bailing business
5. Exhibition service
6. Cultural and entertainment business
7. Construction business
8. Public transportation business
9. Photography
10. Hospital
11. Nursing home, Clinic, polyclinic, operation of rehabilitation house, physiotherapy clinic, Ayurvedic and other alternative hospitals,
12. Industry related to physical exercise, Yoga-meditation or training center,
13. Academic and Training Institution
14. Library, Achieves and museum
15. laboratory
16. Aviation transportation service
17. Sports service, Swimming pool,
18. Operation of cold storage,
19. House clearing, electrical fitting and repair
20. Collection and sanitation of wastes, reprocessing of wastes

21. Business of buying and selling house and land by land development
22. Construction relevant heavy equipment rental, repair and operation
23. Veterinary service
24. Battery recharging
25. Health checkup (services like x-ray, CT scan, M.R.I, ultrasound) and health checkup service
26. Business for operating construction completed infrastructures [service operation such as: meeting conference building, drinking water supply, pipeline related to supply of fuel and fuel based gas, warehouse and storage, airport, bus park, stadium, sports complex, ropeway, road, irrigation, electricity transmission, electricity house, railway service, cargo complex, Inland Clearance Depo (I.C.D.)]business
27. Food beating, grinding and packing activities
28. dying, sizing and printing of cloth and thread (other than done by cloth knitting industry for own purpose)
29. Transport and cargo business or service,
30. Custom Agent service,
31. Packaging, refilling service (including L.P.G Gas refilling and vehicle gas refilling station)
32. Courier service
33. Dry-cleaning business
34. Beauty parlor
35. Interior decoration
36. Business providing security service
37. Publication service
38. Advertisement service
39. Service related to preparing advertisement materials
40. Industry related to general information dissemination service,
41. Program made for broadcasting via television and production & transmission of documentary telefilm
42. Soil testing service
43. Water purification, delivery and distribution service,
44. Health club
45. Operation related to zoological, geological, biotech park
46. Business Incubation service
47. Operation of trading business complex
48. Foreign employment service
49. Cinema hall including multiplex,
50. Theater including multiplex,
51. Stitching, Knitting
52. Electricity survey
53. Minerals study and research
54. Research and development service
55. Sanitation service
56. Wholesale and retail business service
57. Industry related to e-commerce, industry business providing services to the general public via electronic portal (online or software or applications or other medium of similar nature),

58. Industry related to service of leasing machinery equipment,
59. Industry related to service business such as purification or processing of cut-to-length sheet, photo film, slitting, ball wiring assembly produced in nominal amount and importing finished goods in bulk and repacking,
60. Business related to clothing and yarn designing, yarn sizing, and printing on clothes (except weaving industry doing such for its own purpose),
61. Industry related to veterinary service operated as a business,
62. Service apartment,
63. Food court, catering, and mobile food stalls,
64. Service related to equipment repairing and installation, ready mix concrete, export house, technology and invention center, service relating to providing facilitated workspace.

Schedule-9

(Related to section 19)

National Priority Industry

1. Cottage industry,
2. Energy based industry,
3. Industries based on agriculture and forests products,
4. Infrastructure industry,
5. Export Industry,
6. Industries relating to adventure tourism along with infrastructure, village tourism, eco-tourism, golf course, polo, pony trekking, trekking, water rafting, conference tourism, religious tourism, cultural tourism, fun park construction and operation, wildlife reserves,
7. Mining industries, petroleum, natural gas and fuel exploration and extraction,
8. Industries producing cement and clinker using native limestone, pulp and papers, sugar, chemical fertilizers (except mixing), compost fertilizer, shoes, sandal, thread, animal husbandry, fishery, bee-keeping, floriculture, primary processing of rubber based on native raw material, and rubber or rubber based product manufacturing, powder milk, medicines production, processing of solid waste and unused materials, Industries manufacturing energy-saving instruments, industries that manufacture pollution-reducing instruments, Industries manufacturing means and instruments to be used by persons with disability, Industries manufacturing agricultural tools and machinery and industrial instruments, Industries manufacturing electric vehicles, industries producing medicines for snake bite, industries producing artificial eye lens.
9. Hospitals, nursing homes, veterinary hospital and clinics, health checkup services, health laboratory, bioresearch laboratory, teaching and training institutes to be established outside Kathmandu Valley, Metropolitan city and Sub-metropolitan areas of Terai region,
10. Information Technology industry
11. Industries located in Industrial Zone, Special Economic Zone and Industrial village constructed and operated by private sector,
12. Industries producing prescribed goods of high price low weight/volume as identified by Government of Nepal by publishing notice in Nepal Gazette,
13. Industry manufacturing goods or service determined by National Unified Business Strategy approved by Government of Nepal,
14. Film Production.

SCHEDULE – 10

[Related to clause (c) of sub-section (2) of section 24]

Classification of District Based on Industrial Development

(A) Least Developed Region

1. Darchula	2. Baitadi	3. Bajhang	4. Bajura	5. Achham
6. Doti	7. Mugu	8. Dolpa	9. Humla	10. Jumla
11. Kalikot	12. Jajarkot	13. Rolpa	14. East Rukum	15. West Rukum
16. Mustang	17. Manang	18. Solukhumbu	19. Khotang	20. Okhaldhunga
21. Taplejung	22. Bhojpur	23. Panchthar		

(B) Undeveloped Region

1. Dadeldhura	2. Pyuthan	3. Myagdi	4. Dailekh	5. Parbat
6. Lamjung	7. Salyan	8. Gulmi	9. Baglung	10. Gorkha
11. Dolakha	12. Ramechhap	13. Sindhuli	14. Sindhupalanchok	15. Rasuwa
16. Dhankuta	17. Sankhuwasabha	18. Terhathum		

(C) Under Developed Region

1. Kanchanpur	2. Kailali	3. Bardiya	4. Dang	5. Surkhet
6. Palpa	7. Arghakhanchi	8. Syangja	9. Kabilvastu	10. Tanahun
11. Nuwakot	12. Dhading	13.Kavrepalanchok	14. Rautahat	15. Sarlahi
16. Mahottari	17. Siraha	18. Saptari	19. Udaypur	20. Ilam

CHAPTER- 7

FOREIGN INVESTMENT & TECHNOLOGY TRANSFER ACT, 2075 (2019)

1. INTRODUCTION

Foreign Direct Investment (FDI) has become a significant part of capital formation and technology transfer in developing countries. It has been widely recognized as a growth-enhancing factor due to its ability to bring an inflow of external resources, introducing modern techniques of management, providing access to new technologies and creating employment opportunities. In a country like Nepal, it can also help finance the current account deficits by promoting export and substituting import. Also, more productive and efficient foreign firms help to stimulate industry competition.

There are three common purposes of foreign direct investment i.e. resource-seeking, market seeking, and efficiency-seeking. The availability of natural resources promotes resource-seeking motive of FDI. Market-seeking objective is influenced by the host country's domestic and regional market size and market growth. Lastly, efficiency-seeking purpose is to take advantages of factors that enable them to compete in international markets such as labour cost, distance to relevant markets and availability of reliable suppliers. Efficiency also takes place when there are open and developed cross-border markets. Nepal as a host country with abundant natural resources and being situated at an economically strategic location between two giant economies, it has the potential of retaining foreign investors that are beneficial for the country's growth.

Foreign Direct Investment was found as an engine of economic growth in India. There was evidence that it would facilitate technology transfer and bring development in the required sectors if the government adopts a more active and open policy to attract FDI inflows. Implementation of investment friendly policies and proper regulations helps to render a smooth functioning of FDI. In Nepal, government has formulated friendly policies to liberalize the inflow of Foreign Investments such as permitted to have hundred percent ownership by foreign investors, decontrol of prices by the government, simplification in import of machinery and raw materials, minimum approval procedures and corporate income tax for manufacturing being one of the lowest in the region.

Realizing the contribution and impact of foreign investments for the growth of the economy, Nepal has taken various steps to foster and encourage foreign investment in the country at an international level. Some of the key institutional activities that have been accomplished are as follow:

- Nepal is a member of the World Intellectual Property Organization (WIPO) and the Multilateral Investment Guarantee Agency (MIGA).
- Nepal has entered into Bilateral Investment Treaties (BITs) with 6 countries i.e. France, Germany, Mauritius, Finland, United Kingdom and India.
- Nepal has also entered into Double Taxation Avoidance (DTA) Treaties with 11 countries, namely, India, Norway, China, Pakistan, Sri Lanka, Austria, Thailand, Mauritius, South Korea, Qatar and Bangladesh.
- To ensure access to the vast potential market, Nepal is a member of WTO, SAFTA, and BIM-STEC.

- Nepal is also a signatory to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States and a member of the International Centre for the Settlement of Investment Disputes (ICSID), associated with the World Bank.

The inflow of FDI has been low even though Nepal has been developing institutional and legal infrastructure to ease doing business since the 1980s. Foreign Direct Investment in Nepal increased to NPR 17512.80 Million (USD 152.76 Million) in 2018 and averaged NPR 4159.94 Million (USD 36.3 Million) from 2001 to 2018.

With a feeble capacity of the private sector and weak financial position of the government, it is very important for countries like Nepal to have FDI for its sustainable growth and development in the country. Nepal can now ensure investors' confidence in its policies, as the nation has a stable government and has also established the federal states. There are many untouched sectors with huge potential in Nepal. For instance, the lack of infrastructure development is very evident in Nepal. It will be a win-win situation to have FDI in those sectors. Investment Board of Nepal has also identified potential investment sectors for FDI i.e. hydropower, transport, agriculture, tourism, information communication technology, mines and minerals, health and education, manufacturing and financial institutions.

Nepal has been taking initiatives to bring more investment friendly policies, however, it should keep updating the policies according to new innovation and the changing culture. Foreign Investment and Technology Transfer Act, 2075 (2019) was promulgated on 13thBaisakh 2075 replacing the previous Act enacted in 2049 (1992) with the following objectives:

- To make optimum utilization of available resources for economic prosperity of the country,
- To make national economy competitive or generate employment,
- To substitute import by increasing productivity and promoting export,
- To attract foreign capital, technology and investment in the areas of infrastructure development or production of goods or services,
- To make investment friendly environment for sustainable economic growth rate through industrialization,
- To amend and consolidate existing laws relating to foreign investment and technology transfer.

In this Act, following terminologies are defined as follows:

(a) Industry: "Industry" means any Industry established pursuant to prevailing industrial enterprises laws.

(b) Foreign Investment: "Foreign Investment" means the following investments made by foreign investor in industry or company:

- Share investment made in foreign currency,
- Re-investment in an industry of dividends derived from foreign currency or shares,
- Lease finance made in accordance with Section 6,
- Investment made in venture capital fund in accordance with Section 9,
- Investment made in listed securities through secondary securities market in accordance with Section 10,

- Investment made by purchasing shares or assets of a company incorporated in Nepal,
- Investment received through the banking channel after issuing securities in a foreign capital market by an industry or company incorporated in Nepal in accordance with Section 11,
- Investment made through technology transfer, or
- Investment maintained by establishing and expanding an industry in Nepal.

(c) Technology Transfer: "Technology Transfer" means any transfer of technology to be made under an agreement between an industry and a foreign investor on the following matters:

- Use of any patent, design, trademark, goodwill, technical expertise, formula, process of foreign origin,
- Use of any user's license, knowhow sharing or franchising,
- Acquiring any foreign technical consultancy, management and marketing service or other technical skill or knowledge.

Examples of the foreign investment and technology transfer in Nepal can be given as follows:

(i) Brittania India entered into an agreement for transfer of technology of biscuit making with a local industry so that the local industry can make biscuits to the international standards. It also allowed the local industry to manufacture certain biscuits under the trade brands of the Brittannia. But there was no capital investment by Brittannia.

(ii) Eveready Battery company entered into an agreement with the local company to provide the latest know how developed as a result of research in the laboratories of Eveready Battery company in the foreign countries as and when they were available, to provide production supervision to ensure the quality of the product and to allow the right to use the "Eveready " brand for the products manufactured in Nepal. They invested in the company also.

(iii) More recently Hindustan Lever Limited entered into an agreement with Unilever Nepal Ltd. to provide technical assistance and know-how to manufacture the various products and also the right to use for its products the brand names owned by Hindustan Lever. They invested in the company also.

(iv) Previously East India Hotels Limited of Oberoi Hotels India entered into an agreement with Soaltee Hotel to provide management services and train the local people in Hotel Management. But there was no capital investment.

In respect of such technology transfer, payment may be at a rate related to turnover say from 3% to 8% or on the net profits before interest, tax and depreciation, say 8% to 15% or shares may be issued in lieu of such technology transfer without receiving any cash for the same. The Department only after considering the reasonableness of the rate will give permission for such technology transfer.

(d) Foreign Investor: Foreign investor" means any foreign individual, firm, company, Non-resident Nepali or foreign government or international agency or other corporate body of similar nature that makes foreign investment, and also includes, in the case of a foreign investor that is an institutional foreign investor, the ultimate beneficiary of such an institution.

(e) Foreign Institutional Investor: "Foreign Institutional Investor" means foreign company, organized institution or international agencies making foreign investment.

(f) One Stop Service Center: "One Point Service Center" means 'one point service center' established pursuant to prevailing industrial enterprises laws.

(g) Non-resident Nepalese: "Non-resident Nepalese" means person who has obtained nonresident Nepalese identity card pursuant to prevailing nonresident Nepalese laws.

(h) Board: "Board" means Industry & Investment Promotion Board pursuant to prevailing industrial enterprises laws.

(i) Ministry: "Ministry" means Ministry of Industry, Commerce & Supply of Government of Nepal.

(j) Investment Board: "Investment Board" means Investment Board pursuant to prevailing investment board laws.

(k) Foreign Investment Approving Body: "Foreign Investment Approving Body" means body pursuant to section 17. Section 17 of the Act provides that foreign investment up to Rs. 6 billion shall be approved by the Department and foreign investment exceeding Rs. 6 billion shall be approved by the Investment Board established pursuant to Investment Board Act, 2068.

(l) Department: "Department" means the Department of Industries.

Areas of Foreign Investment

Foreign investor may make investment in any industry and receive benefit (interest, dividend) from such investment. Foreign investment shall not be allowed in any industry prescribed in the Schedule to the Act as follows:

- Poultry farming, fisheries, bee-keeping, fruits, vegetables, oil seeds, pulse seeds, milk industry and other sectors of primary agro-production,
- Cottage and small industries,
- Personal service business (hair cutting, tailoring, driving etc.),
- Industries manufacturing arms, ammunition, bullets and shell, gunpowder or explosives, and nuclear, biological and chemical weapons; industries producing atomic energy and radio-active materials,
- Real estate business (excluding construction industries), retail business, internal courier service, local catering service, money changer, remittance service,
- Travel agency, guide involved in tourism, trekking and mountaineering guide, rural tourism including home stay,
- Business of mass communication media (newspaper, radio, television and online news) and motion picture of national language,
- Management, account, engineering, legal consultancy service and language training, music training, computer training, and
- Consultancy services having foreign investment of more than 51 %.

However, technology transfer may be permitted in such industry established with Nepali Investment with the permission of the Department. Government of Nepal may not give permission for foreign investment in any industry below the prescribed amount by publication of notice in the Nepal Gazette.

Modes/Types of Foreign Investment

A foreign investor may make foreign investment in following modes/types:

(a) Individual or Joint Investment

A foreign investor may invest in any permitted industry individually or jointly, or through joint investment with Nepalese citizen or industry established in Nepal.

(b) Purchase of Assets or Shares of the Industry

A foreign investor can invest in any industry established in Nepal by acquiring the assets of the industry or shares not exceeding prescribed percentage.

(c) Leasing Financing

The Act has introduced lease financing as one of the modes for foreign investment in Nepal. A foreign investor may make foreign investment, subject to the prescribed ceiling, in any aircraft, ship, machinery and equipment, construction equipment or similar other equipment.

(d) Technology Transfer

A foreign investor may make foreign investment in any industry established in Nepal through transfer of technology by entering into agreement with the Nepali industry, approved from the Foreign Investment Approving Body. The terms and conditions of the technology transfer shall be as specified in the agreement between the concerned industry and foreign investor. Royalty in excess of the amount as specified in the agreement shall not be repatriated. The Foreign Investment Approving Body may prescribe appropriate terms and conditions considering international practice on foreign investment and production and sales capacity of the industry while granting permission for technology transfer.

(e) Establishment of Branch Office

Foreign Investment may be made by the establishment or extension of a branch office of a foreign Industry in Nepal. The provisions relating to establishment or extension of such branch office shall be as prescribed.

(f) Establishment of Venture Capital Fund

Section 9 provides, an institutional foreign investor may establish a venture capital fund by incorporating a company in accordance with the prevailing law, and by obtaining approval of the Securities Board for the purpose of investing equity in any industry. An approval shall have to be obtained by fulfilling the procedures referred to in Section 15 for the investment in an industry from the venture capital fund. Such a company shall provide the statements of the venture capital fund to the Department in every six months.

Further, section 10 of the Act provides that such investor shall be required to be registered with Securities Board of Nepal to carry securities transactions. The registered foreign investors may trade in securities of the industries permitted for foreign investment through the secondary securities market. The minimum number of securities to be purchased, investment limit, minimum securities holding period, reserve fund to be held in foreign currency for purchasing securities and other provisions relating thereto shall be as prescribed.

(g) Borrowing Loan or Acquiring Foreign Currency by Issuing Securities

Any public limited company incorporated in Nepal or a corporate body authorized under the prevailing law to issue securities may borrow a loan or acquire foreign currency by issuing bonds, debentures or other securities in the capital market of a foreign country with the approval of the Nepal Rastra Bank and the Securities Board. A company which is incorporated with foreign investment in Nepal may, subject to the prevailing law relating to securities, borrow a loan by issuing securities within Nepal. The loan borrowed or foreign currency acquired shall have to be invested in Nepal.

(h) Borrowing Loan from Foreign Financial Institution

Any industry having foreign investment may on the recommendation of the Ministry and with the approval of the Nepal Rastra Bank borrow a project loan or a loan by entering into a project financing agreement with any foreign financial institution in accordance with the prevailing law.

Maximum Limit of Foreign Investment

No maximum ceiling of the amount to be invested and the share (portion) of investment by a foreign investor wishing to make investment in Nepal shall be prescribed. However, maximum limit may be imposed for the following investments:

(a) Investment made in securities pursuant to section 10.
(b) Investment in the service industry (as not to be lesser than the commitment made by Nepal in respect of the concerned sector or sub-sector at the time of obtaining membership of the World Trade Organization).

2. APPROVAL OF FOREIGN INVESTMENT AND REPATRIATION

Process of Foreign Investment

Section 15 of the Act has laid down the provisions relating to the approval of foreign investment. Any foreign investor desirous of making foreign investment pursuant to this Act may file an application in the prescribed form together with the relevant documents for approval of foreign investment to the Foreign Investment Approving Body. The timeline for the investment to be made in the industry where investment will be made and the work plan of the investment shall also be submitted.

After processing of the application and making necessary inquiry, if it is deemed appropriate, the Foreign Investment Approving Body shall grant approval for foreign investment in the prescribed format within 7 days of receiving of application. Approval of reinvestment in the

same industry or other industries not included in the negative list from profits earned is not required by an industry which has already been granted approval.

If it is not appropriate to grant approval for foreign investment, the Foreign Investment Approving Body shall give information to the applicant within 7 days along with necessary grounds and reasons. If the concerned investor is not satisfied with the decision of the Body, it may make an application to the Ministry for the review of such decision. The Ministry shall make decision within 30 days of receipt of application.

After obtaining approval for foreign investment, the foreign investor shall notify and make self-declaration to Nepal Rastra Bank that the investment is brought from its legal source. The foreign investor shall be allowed to bring the amount of foreign investment in Nepal after such notification. The foreign investor shall bring the amount of investment in convertible foreign currency through banking channel by fulfilling the formalities determined by Nepal Rastra Bank. However, Indian Investor may make investment in Indian currency through banking channel.

Repatriation of Investment or Earnings by Foreign Investor

The foreign investor may repatriate the capital from sale of its shares or business in Nepal after payment of all taxes pursuant to Nepalese laws.

The foreign investor may repatriate the following amount in the currency in which foreign investment was made or in another convertible currency with the approval of NRB after payment of all taxes pursuant to the prevailing laws:

- Amount received from the sale of shares with foreign investment,
- Amount of profit or dividend received from foreign investment,
- In the case of liquidation or winding up of the industry or company, amount remaining after paying all liabilities following the liquidation or winding up,
- Amount of royalty received under the technology transfer agreement (however, in the case of the royalty or fee for the use of a trademark under the transfer of technology in a liquor industry other that a liquor industry exporting cent percent of liquor, the amount of such royalty shall not exceed 5 % of the total selling price excluding the prevailing tax.
- Amount of lease rent under the lease investment,
- Amount received as damages or compensation, if any, received from the final settlement of a law suit, arbitration or any other legal process in Nepal,
- Amount received from the auction of property situated in Nepal accepted as collateral in providing loan to any industry or company, in case of default of such loan.
- Amount that can be repatriated in accordance with the prevailing law.

Any foreign investor desirous of repatriation of foreign investment or income of foreign investment may submit an application in the prescribed format to the Foreign Investment Approving Body for approval. However, such an application shall be made to the One Stop Service Centre, if the Government of Nepal, by a notification in the Nepal Gazette grants to the One Stop Service Centre, the power to give approval relating to repatriation of foreign investment or amount earned therefrom. If the foreign investor has complied conditions and liabilities pursuant to this Act, prevailing laws or the agreement relating with the foreign

investment, the Body shall grant approval of repatriation within 15 days from the date of receipt of application. After receiving of approval from the Body, the foreign investor may make an application to Nepal Rastra Bank for foreign currency exchange facilities. After receiving of application, Nepal Rastra Bank shall provide exchange facilities to the foreign Investor for the repatriation of foreign investment.

If the foreign investor is not satisfied with the decision of the Body relating to repatriation of foreign investment, he/she may file an application to the Ministry. The Ministry shall make decision on the application within 30 working days.

3. PROMOTION, FACILITATION & REGULATION OF FOREIGN INVESTMENT

Function, Duties & Power of the Board

In addition to other functions, duties and powers mentioned in the Act, the Board shall have the following functions, duties and powers:

- To give suggestions to the Government of Nepal for such policy, institutional and procedural reforms as may be required to be made for the attraction of foreign investment in industrial and infrastructure development,
- To set such strategies and programs as may be required for the enhancement of attraction of foreign investment in Nepal and promotion and protection thereof,
- To give approval for the establishment of industries and infrastructures with foreign investment, and promote foreign investment,
- To facilitate for foreign investment by enhancing, expanding and protecting foreign investment,
- To make coordination at the policy and implementation levels of foreign investment,
- To assist in the implementation of policies and laws relating to foreign investment,
- To make arrangements for the provision of services to foreign investors from the One Stop Service Centre,
- To obtain information as to whether activities of giving approval for foreign investment and delivery of services have been carried out properly, and give necessary direction to the concerned body,
- To make facilitation, if there arises any problem in respect of the repatriation of foreign investment or amount earned, as referred to in Section 20 or implementation of this Act or the rules framed under this Act, in that respect,
- To perform, or cause to be performed, such other functions as prescribed.

Function, Duties & Power of the Department

In addition to other functions, duties and powers mentioned in the Act, the Department shall have the following functions, duties and powers:

- To create conducive (friendly) environment for the establishment and operation of industries to be established with foreign investment,
- To facilitate foreign investors to obtain any approval or permission including initial environmental assessment, environmental impact assessment in accordance with the prevailing law,

- To maintain updated records of foreign investments approved or permitted in accordance with this Act or the prevailing law and of the technology transferred in Nepal, update such records and make the same public periodically,
- To give approval for foreign investors, and foreigner experts, technicians or managerial employees who are engaged in the industries with foreign investment pursuant to Section 27 to repatriate investment and remuneration,
- To make and enforce Standard Operating Procedures in order to make foreign investment transparent and to make procedural simplification,
- To make recommendation for visas to the foreign investors and their authorised representatives, and foreign experts, technical or managerial employees engaged in industries with foreign investment in accordance with Section 27 and minor members of their family, and make facilitation for that purpose,
- To make regular supervision and monitoring as to whether any industry with foreign investment has misused any facility granted in accordance with this Act,
- To facilitate industries with foreign investment in establishing industries in an industrial zone or special economic zone,
- To perform, or cause to be performed, such other functions as prescribed.

Services/Facilities Provided Through One Stop Service Center

Government of Nepal may make necessary arrangement to provide necessary concessions, facilities, rebate or services to the foreign Investor through One Stop Service Center. The following services shall be provided through One Stop Service Center:

- Registration and administration of industries,
- Approval of foreign investment and loan,
- Registration and administration of companies,
- Labour permit,
- Visa facility,
- Testing and control of quality of goods produced by industries,
- Approval of environmental study report,
- Energy and infrastructure development, and necessary coordination for that purpose, as well as focal point among other bodies,
- Exemptions, facilities to which industries are entitled,
- Provision of permanent account number,
- Foreign exchange approval,

Any service related to such other functions as may be required to be performed for industries in accordance with this Act and the Regulation framed under this Act.

4. FACILITIES TO INDUSTRY WITH FOREIGN INVESTMENT OR FOREIGN INVESTOR

The Act has granted following exemptions, facilities and concessions to the industry established with foreign investment or foreign investor in order to establish Nepal as an attractive center for foreign investment:

(a) Facilities Availed by the Industry

In addition to the concessions, facilities and incentive or protection granted by this Act, all other such facilities provided by Industrial Enterprises law and other prevailing laws shall be granted to industries with foreign investment. However, facilities available to sick industries pursuant to prevailing laws shall not be available to such industries.

(b) Facility to Deal with Foreign Currency

A foreign investor or industry with foreign investment may open an account in Nepali currency with any commercial bank, infrastructure development bank or financial institution of Nepal and in foreign currency with any bank or financial institution licensed to deal with convertible foreign currency in accordance with the prevailing law and carry on transaction accordingly. However, approval of Nepal Rastra Bank shall be obtained to carry on transaction by opening an account in convertible foreign currency. An industry with foreign investment may, in order to mitigate the foreign currency exchange fluctuation risk, use any approved derivatives equipment through a bank or financial institution.

(c) Foreign Exchange Facilities

Industries with foreign investment may avail foreign exchange facilities with the approval of NRB on the recommendation of Foreign Investment Approving Body for the following purposes:

- Payment to the foreign experts, highly skilled technicians, managerial level employees employed in the industry,
- Payment of principal or interest of bond or debenture issued in capital market of foreign country,
- Repatriation of foreign investment or income earned from the investment.

(d) Hiring Expatriates

Hiring of expatriates as experts in key managerial position, technical experts, managerial and technical staff may be done by industry with foreign investment pursuant to prevailing laws if qualified Nepali nationals are not available for such positions. The concerned industry shall provide particulars of hired expatriates to the Department. The Department shall provide such particulars to the Ministry of Finance, Ministry of Home Affairs and Ministry of Labour, Employment and Social Security.

(e) Industrial Security

Industries established with foreign investment shall be provided industrial security equivalent to industries established in Nepal.

(f) Facility of identity card

The Department may provide an identity card in the prescribed form to any foreign investor who makes such foreign investment as prescribed.

(g) Visa Facility

(i) Non-tourist visa:

A non-tourist visa up to 6 months shall be granted to a foreign national visiting Nepal for conducting study, research or survey for foreign investment in Nepal. Foreign specialist, technician or managerial staff working in industry with foreign investment shall be granted non-tourist visa as per necessity.

(ii) Business visa:

A foreign investor or family member or authorized representative of such foreign investor or family of such authorized representative shall be granted business visa until the foreign investment is retained. In case investment is made in excess of the prescribed amount, visa facility shall be granted to maximum two persons and their family member.

Note: 'Family member' means husband or wife, father, mother and minor son or daughter of the foreign investor or his/her authorized representative.

(iii) Residential visa:

Foreign investor or family member or authorized representative of such foreign investor or family of such authorized representative who, at a time, makes an investment in excess of US dollars 1 million or in equivalent convertible foreign currency shall be granted residential visa until such investment is retained.

(h) Land Facilities

An industry where foreign investment has been approved may acquire land for setting up an industry or may lease land for the purpose. Where land cannot be identified by the investor, or where the land required is in excess of the prescribed ceiling, the foreign investment approving body shall provide necessary arrangement, recommendation, coordination and facilitation.

(i) National Treatment

Foreign investment made after the commencement of this Act is to be treated in same terms applicable on management, maintenance, utilization, transfer or sale of investment made by Nepalese person, until such investment is retained in Nepal. However, previous law is applicable for foreign investment approval obtained under the previous law and no change in law is to be made without the consent of foreign investor in a manner that is detrimental to any facilities enjoyed by the foreign investor under such law.

Industry with foreign investment after the commencement of this Act shall be provided following preservations:

- The industry, enterprise with foreign investment shall be accorded the same treatment as accorded to any industry of the same nature with investment made by a Nepali citizen.
- The industry, enterprise with foreign investment shall be free to determine the price of goods and services, subject to the prevailing law.

- The industry, enterprise with foreign investment shall not be prevented from doing trade, as prescribed, being limited to that industry.
- The industry, enterprise with foreign investment shall not be restricted to repatriate profit, investment, pay interest of, and repay the principal of a loan.

National treatment is not applicable in respect of the following matters:

- Matters relating to the creation of such intellectual property rights, limits thereof, transfer of title thereto or provisions requiring compulsory licensing for the use thereof as specified in any agreement made under the World Trade Organization,
- Matters relating to the exemption or facility, if any, granted to any domestic industry or goods in accordance with the prevailing Nepal law relating to public procurement,
- Matter relating to any grant or concession to be made or provided by the Government of Nepal,
- Matter of non-commercial services to be provided by the Government of Nepal,
- Such measures relating to financial services as may be adopted or managed by the Government of Nepal upon considering appropriate on matters such as matters relating to the protection of investors, participants in the securities market, insurance policy holders or insurance policy claimants, or relating to financial institutions having liability to safeguard the financial interests of any persons or relating to maintaining soundness, morality or financial responsibility of financial institutions,
- Matters involving liability or provision to accord special treatment by the Government of Nepal because of being a party to any regional or multilateral economic, monetary organization or organization of similar nature to which the Government of Nepal is or will be a party,
- Matters relating to the terms that may be specified by the regulatory body in accordance with the prevailing law in respect of repatriation of investment to a foreign country, repayment of loan (including principal, interest and fees), payment of service fees,
- Matters relating to the protection of human, animal and plant health or the environment.

(j) Industry not to be Nationalized

Industry with foreign investment pursuant to this Act shall not be nationalized. No industry shall, except for a public purpose, be expropriated directly or indirectly. If it is required to expropriate it for the public purpose, due process referred to in the prevailing law shall be fulfilled.

5. MISCELLANEOUS

Grievance Management

If any foreign investor or industry has any dissatisfaction or complaint against any decision or action taken by officer responsible for registration, regulation or monitoring of industries or officer of One Stop Service Center, it may file an application to the Department for hearing stating the matter. The Department shall address the above complaint as prescribed.If any foreign investor or industry has any dissatisfaction or complaint against any decision or action taken by the Department or One Stop Service Centre, it shall file an application to the Ministry for hearing stating the matter.The Ministry shall address the complaint as prescribed.

Settlement of Dispute

If there arises any dispute between a Nepali investor and a foreign investor in relation to foreign investment, the Department may make necessary facilitation that such a dispute is settled by the concerned parties through mutual discussions or negotiations. If dispute could not be resolved by mutual discussion or negotiation within 45 days of arising of dispute, the dispute shall be resolved as per joint investment agreement or dispute resolution agreement if any. The Department of Industries or the Investment Board should be informed about dispute resolution within 15 days of resolving such dispute.

If the agreement concluded between the parties has no provision about the settlement of disputes, such a dispute shall be settled by arbitration in accordance with the arbitration law of Nepal. Any dispute arising in connection with any foreign investment shall be settled by arbitration in accordance with the prevailing Rules or Procedures of the United Nations Commission on International Trade Law (UNCITRAL), unless otherwise agreed upon by the parties to the dispute. Arbitration to be conducted in accordance with this section shall be held in Nepal, and substantive law of Nepal relating to arbitration shall apply. However, with respect to the case in which a joint investment or dispute settlement agreement exists between the parties, the provision contained in that agreement shall apply.

In the absence of any such agreement or if the parties feel such agreement is inadequate to resolve the dispute, the parties can enter into an agreement to resolve such dispute even after the occurrence of dispute. The parties shall inform about such agreement to the Department of Industries or Investment Board of Nepal.

Validity Period of Foreign Investment Approval

The approval of foreign investment shall be effective until foreign investment is retained in Nepal. However, the approval of foreign investment shall be deemed to be ipso facto ineffective in the following circumstances:

- The approved investment could not be remitted without reasonable justification within 2 years from the date of approval,
- The entire shares are sold or transferred to a Nepali investor,
- The company is liquidated or the industry license is revoked,

Power of Attorney by Foreign Investor

Person desirous of making foreign investment pursuant to this Act may provide power of attorney to any person to do any, some or all activities on his behalf. All activities performed by the person receiving power of attorney shall be deemed to have been performed by the investor himself/herself. The Power of Attorney shall be certified by the Notary Public and submitted to foreign investment approving body. The person receiving power of authority cannot delegate such authority to any other person. Person providing power of attorney may cancel such authority at any time. The power of authority shall not be effective from the date of the withdrawal of authority is registered with the foreign investment approval body.

CHAPTER- 8

LABOUR ACT, 2074 (2017)

1. INTRODUCTION

History of Labour Legislation in Nepal

History of Labour Legislation in Nepal begins from Ancient and Medieval Period. Before 1910 BS, it used to be regulated by religious scriptures. In ancient time, there used to be laborers related to agriculture, animal rearing and so on. They used to receive salary/wages both on cash and other material things. Later on, when industrialization started, manufacturing of goods, cotton, timber, precious stones like gold, silver etc., medicinal herbs required new kind of laborers. In such context, *Muluki Ain*, 1910 was drafted to regulate varieties of activities including laborer and entrepreneurs. In nutshell, the development of labour legislation in Nepal can be studied as below:

1. Ancient and Medieval Period (Kirat, Lichchavi and Malla Period)
2. *Muluki Ain*, 1910
3. Nepal Company Law, 1993
4. Interim Governance Act, 2007
5. Labour Problem Resolution Commission, 2007
6. Service Regulation Act, 2014
7. *Nepal Karkhana ra Karkhana ma Kaam Garne* Act, 2016
8. Industrial Development Corporation Act, 2016
9. Labour Act, 2048

The Labour Act, 2048 was effective for more than 25 years. Considering the narrow scope of the Act, it has been replaced by the Labour Act, 2074. It has received the assent of president and become effective from Bhadra 19, 2074. The Act also repealed the Industrial Trainee Training Act, 2039 and Retirement Fund Act, 2042. The objective of the Act is as follows:

- To make provisions for rights, interests and benefits of workers and make clear provisions relating to the rights and duties of employers,
- To promote good industrial relation and end all forms of labor exploitation for the growth of productivity,
- To amend and consolidate the laws relating to labor.

The Act applies in the 'Enterprises'. According to clause (j) of section 2 of the Act, 'Enterprise' means any company or private firm or partnership firm or cooperative society or association or any other organization established or incorporated or formed or operated pursuant to the prevailing laws with an objective to carry on any industry or occupation or service with or without any motive to make profit. It is also applicable to entities registered in foreign countries and engaged in the promotion of business, sale of products or promotion of other works in Nepal (section 90).

Section 180 provides that this Act shall not be applicable in the following enterprises/ circumstance:

- In relation to Nepal Army, Nepal Police, Armed Police Force and National Research, this Act shall not be applicable.
- In relation to the civil service, the prevailing law relating to civil service shall be applicable.

- If the employment conditions and benefits in relation to the service established under special law or special economic zone are specified in the prevailing laws, such service shall be governed by the same provisions accordingly.
- Working journalists of an enterprise governed by Working Journalist Act, 2051, unless employment contract is specifically executed pursuant to this Act.
- When giving any decision or order or judgment on inapplicability of this Act in relation to any worker. In giving such decision, the applicable law under which such rights and benefits provided by this Act are entitled must be stated clearly in such decision or order or judgment.

In this Act, following terminologies are defined as follows:

(a) Employer: "Employer" means any person or enterprise who employs workers and it shall also mean managers for the purpose of enterprise and labour supplier for the purpose of workers supplied pursuant to this Act.

(b) Employment period: "Employment period" means the period during which a worker is employed with an employer and shall include the following periods also:

- Period of reserve;
- Period of leave with full remuneration;
- Period of leave taken without remuneration for maternity or maternity care;
- Period of leave taken for medical treatment in case of accident during or while working for the employer.

(c) Basic salary:"Basic Salary" means basic salary which a worker is entitled to receive for employment and it also means salary increment (grade) entitled to receive after one year of employment period.

(d) Collective Agreement: "Collective Agreement" means an agreement signed between an employer or employers' association and trade union or Collective Bargaining Committee on matters relating to remuneration, service conditions, benefits of workers or issues common to employer and workers.

(e) Office: "Office" means the Labour & Employment Office.

(f) Ministry: "Ministry" means the Ministry of Labour, Employment and Social Security, Government of Nepal.

(g) Department: "Department" means the Department of Labour and Occupational Safety.

(h) Social Security Fund: "Social Security Fund" means the Social Security Fund established pursuant to the prevailing laws.

Section 3 states that this Act shall act as a minimum standard for workers and on matters relating to the workers. If any employment contract between an employer & a worker is made with

provisions to pay or receive remuneration or benefits lesser than remuneration & benefits prescribed by the Act or rules made under this Act or in breach to conditions prescribed in the Act, such employment contract shall be deemed to have violated the Act and to that extent, it shall be null and void.

Prohibition on Employment of Children and to Engage in Forced Labour

Section 5 of the Act strictly prohibits employment of children in any work by any person against the prevailing laws. Section 4 provides that a person shall not directly or indirectly employ any person in 'forced labour'. Forced labour means any work or service performed by any worker against his/her will as a result of a threat of taking any action having financial, physical or mental impact if he/she does not perform such work. However, the following acts or services carried out by workers shall not constitute forced labour:

- Any work or service to be performed as civil obligation when nation requires,
- Any work or service required to be performed by any person as a consequence of punishment given by a decision or an order of a court,
- Any work or service required to be performed in the interest of a community as its member.

Prohibition of Discrimination [Sec. 6]

No employer shall discriminate any worker on ground of religion, colour, sex, caste, tribe, origin, language, ideological, conviction or any other similar ground. However, following activities shall not be considered discrimination:

- To give preference to any person for employment on the basis of inherent (essential) requirement of a job or service,
- To engage a female worker who is pregnant, in any work or service which is easier and suitable to her condition without any reduction in the remuneration and benefits,
- To give preference to any physically challenged worker in any job responsibility suitable to his/her physical condition.

Workers shall not be discriminated in the payment of remuneration for equal value of work on the basis of their gender. The nature of the related work, the time required for the performance of the work, labour, skill and productivity shall be duly considered in determining whether the work is of equal value or not.

Types of Employment [Sec. 10]

The Act recognizes following types of employment on which an employer may engage a worker:

(a) Regular employment: Any employment other than those specified in (b), (c) and (d).

(b) Task based employment: An employment in which a particular task or service specified by the employer is required to be accomplished.

(c) Time based employment: An employment in which a worker is required to provide a service or accomplish a task within a period fixed by the employer.

(d) Casual employment: An employment in which a worker is engaged for 7 or less than 7 days within a period of 1 month to provide any service or accomplish a given task.

(e) Part time employment: An employment in which a worker is engaged by the employer for 35 hours or lesser than 35 hours in a week to accomplish any work.

Employment Contract

Employment contract is a contract entered between an employer and employee specifying the remuneration, benefits, employment conditions and other matters relating to the employment. It is an appointment letter given to a worker by an employer. The following matters shall also be included in the employment contract [Sec. 11]:

- Job description and position.
- Bylaws framed pursuant to section 108 of the Labor Act, 2074 to be an indispensable part of the contract.
- Place, time and effective date of implementation of the contract.
- Other relevant employment terms.

No employer shall employ any worker without entering into an employment contract. However, it shall not be necessary to enter into a written employment contract for casual employment.

An employment relationship between an employer and a worker shall be deemed to have been formed where an employer executes an employment contract with a worker, or employs a worker verbally, or in case of casual employment, from the date or time such worker is employed or the service is provided by such worker. Where any dispute arises with regard to the existence of an employment relationship between an employer and a worker, such dispute shall be settled by the Office. The Office may give an order to employer to submit any evidence or document relating to employment which is in his/her possession. If such evidence or document is not produced as ordered, the employment contract between the employer and worker shall be deemed to have been formed[Sec. 12]

Section 13 of the Act provides provisions relating to probation of workers. Any employer when executing an employment contract with a worker may keep him/her in probation for a period of 6 months. The contract with such worker may be terminated if his/her work is not satisfactory during the probation period. If the employment contract with such worker is not terminated after the end of the probation period of such worker, it shall be deemed automatically valid.

Continuity of Employment Relationship in the Change of Ownership

If there is a change or transfer of ownership of any work or business or any part of such work or business of any employer or hand over of the work or business to any other person for operation or formation of a new enterprise or business as a result of merger of two or more than two enterprises or businesses, the employment relationship of the workers working in such enterprise or business in which the ownership has been changed or transferred or business has been handed over for operation or the enterprise or business that has been merged shall continue.

The employer taking the ownership or acquiring ownership after handover or operating the activities or business shall be responsible for the liability as per the Act or the Rule made under

this Act or collective agreement if it has been entered into. Similarly, a new enterprise or business entity formed after the merger of enterprises or businesses, or any enterprise taking the ownership and liability in case of transfer of ownership, and liability of a project under the prevailing law relating to the private sector investment in the infrastructure development and operation shall be responsible. However, if any agreement on provisional arrangement among the main employer, new employer and trade union of the concerned enterprise has been made, the provisions in such agreement shall be applicable accordingly**[Sec.** 14].

Continuity of Employment Relationship During Period of Reserve [Sec. 15]

Reserve is a situation in which employer may stop the work and keep the workers in retention in case any special situation arises. Special situation means shortage of electricity, water, raw material or lack of fund or inability to reach the workplace or work or operate the workplace because of any situation beyond control. The employment relationship between the employer and workers shall continue during the period of reserve.

Any employer employing ten or more workers may keep workers in reserve for a maximum period of 15 days. In case there is a need to keep workers in reserve for more than 15 days, the employer shall consult authorized trade union or Labour Relation Committee. Workers, who are kept in reserve pursuant to this Act, shall be paid half of their remuneration which they are entitled to until the work is resumed by the employer. Such workers shall not be required to give attendance in the workplace during the reserve period unless the requirement of attendance is mentioned in such notice.

2. PROVISIONS RELATING TO TRAINEES, APPRENTICES & PART TIME WORKERS

Hiring of Trainees in Work

Any enterprise may hire any person as a trainee pursuant to the requirement of the approved syllabus of any educational institution by signing an agreement with such institution. The trainee shall not be considered a worker for the purpose of this Act. However, if any person is hired in contravention to the approved syllabus, he shall be deemed to be a worker under the regular employment relationship [Sec. 16].

Trainees hired pursuant to this Chapter shall not be required to work more than 8 hours a day and 48 hours a week. Provisions relating to occupational health and safety shall be applicable to trainees also. If a trainee meets with an accident during work, unless otherwise agreed between enterprise and educational institution, the enterprise shall provide medical treatment and compensation, which a worker of such enterprise is normally entitled to under this Act, if injured[Sec. 17].

Use of Apprentice in Work [Sec. 18]

Employer may employ any person as an apprentice providing on the job training. Such training period shall not be more than one year. However, if a training period is prescribed for a specific nature of work under the prevailing law or specific training period is required, an apprentice may be accordingly employed for such period as prescribed. Any employer when employing a person as an apprentice pursuant to this section, shall provide, at the minimum, the benefits equivalent

to the minimum wage and other social security benefits including sick leave, gratuity, provident fund and insurance. No employer shall be under compulsion to continue the employment of the apprentice after the completion of the training period. However, if the employment of such apprentice is continued after the training period by the employer, the provision of probation period shall not be applicable in his/her case.

Part Time Employment

An employer may employ any worker for part time only. However, any worker working full time shall not be employed in part time work without his/her approval. Remuneration of part time workers shall normally be fixed either on the basis of working hours or on the basis of the employment contract entered between the two parties. In determining the remuneration of part time worker, the monthly remuneration of a worker working full time in the same position and same nature of work shall be taken as the basis for calculation. If any part time worker is required to work overtime, such worker shall be paid remuneration at the rate of 1.5 times of the remuneration he/she is entitled[Sec. 19]

Part time workers shall not be restricted from working elsewhere for others**[Sec. 20]**. In relation to a part time worker working for more than one employer, each employer shall on the basis of basic salary the worker is entitled to receive, make contribution for gratuity, provident fund and other related social security benefits **[Sec. 21]**.

3. PROVISIONS RELATING TO WORK PERMIT

Employment of Foreign Citizen [Sec. 22]

Work permit is an official document that allows a foreigner to work in a country for a particular period. Employer shall not employ any foreign citizen in any enterprise without acquiring work permit from the Department. However, if the employer is unable to acquire skilled workers from among Nepali citizens as required, foreign workers may be employed as follows:

Before employing foreign workers, the employer shall publish an advertisement in national daily newspaper in order to acquire skilled workers from among the Nepali citizens. However, advertisement shall not be required to be published in case of technical or expert foreign national required by different Ministries or department of Government of Nepal, Investment Board and organizations or institutions fully or partially owned by Government of Nepal or other authorized entitiesat matters mentioned under an investment agreement entered after taking the approval of Government of Nepal or concerned Ministry. On failure to receive applications from Nepali citizens as specified in the advertisement or Nepali citizens could not be selected, the employer may give an application along with the supporting documents for work permits to the Department for hiring foreign workers. Upon receipt of an application, the Department may issue work permit for the appointment of skilled foreign workers, if the application and other supportive documents are found reasonable upon examination. The employer employing foreign workers after acquiring the work permit shall make arrangement for successive replacement of foreign workers by Nepali workers.

Requirement of Work Permit for Foreign Nationals to Work in Nepal [Sec. 23]

Any foreign national seeking to work in Nepal is required to take work permit as prescribed. Notwithstanding anything contained elsewhere in this Act, every foreign national desirous of working in Nepal shall be required to take work permit as prescribed unless such permit is exempted under diplomatic immunity or any treaty or agreement entered with Government of Nepal.

Work Permit for Special Conditions [Sec. 24]

The Department may after maintaining proper record, issue work permit to foreign nationals in the following conditions:

- A Chief Executive and specified number of workers in an enterprise operated with foreign investment or foreign assistance;
- Any technician required for repairing or maintenance of any machine or installation of any new technology or any other unforeseen work for a period of three or less than three months.

Other Provisions Relating to Foreign Worker [Sec. 25]

An employer shall use or cause to use the language which the foreign worker understands or English language when entering into an employment contract with a foreign worker and providing information relating to his/her job responsibilities and other employment terms and benefits.

Any foreign worker with a work permit acquired pursuant to this chapter shall be permitted to remit the remuneration earned by working in Nepal in any convertible foreign currency to his country [Sec. 26]. Remuneration, employment terms and benefits which a foreign worker is entitled to receive for the work performed shall be as mentioned in the time based or task based employment contract entered between the employer and such worker and they shall not be lesser than the standard prescribed by this Act and rules made under the Act. Unless otherwise mentioned in the employment contract, the period of employment contract shall be valid for three years[Sec. 27].

4. WORKING HOURS, REMUNERATION AND LEAVE

Working Hours and Over Time

Section 28 of the Act provides that no worker shall be employed to work for more than 8 hours a day and 48 hours a week. Workers shall be provided with half an hour rest after five hours of continuous work. Where the work needs continuity without any break, workers shall be provided rest time on the basis of rotation. Such rest time shall be counted within the working hours of the workers.

Section 29 provides that employer shall not compel a worker to work more than 8 hours a day and 48 hours a week. However, workers may be made to work overtime if the non-completion of the work may have an adverse effect on the life, health and safety of any person or serious harm or loss may be caused to the employer. Where an employer requires a worker to work for more than 8 hours a day and 48 hours a week, such worker may be made to work

overtime not exceeding four hours a day and 24 hours a week. When requiring any worker to work overtime, the worker shall be paid remuneration at a rate of 1.5 times of the basic salary that the worker receives during regular hours of work. However, it shall not be a constraint to provide benefits as determined by a collective agreement or benefits as mentioned in the employment contract in lieu of payment for overtime work performed in case of managerial workers.

Remuneration of Workers

Every worker shall be entitled to receive remuneration and benefits from the date s/he commences the work. Remuneration and benefits that a worker is entitled to receive shall be as specified in an employment contract ensuring that they are not less than prescribed in the Act and the rules made under this Act. Except otherwise mentioned in a collective agreement, the remuneration and benefits received regularly by a worker shall not be decreased.

Section 35 provides time for payment of remuneration. When paying remuneration to the workers, if the time is specified in the employment contract, it shall be followed accordingly, or in its absence, it shall be paid at the time determined by the employer. However, the interval between the dates for payment shall not be more than one month. The remuneration to the following workers shall be paid as follows:

- Any worker working for less than one month shall be paid within three working days from the date of completion of the work, and
- Any worker engaged in a casual work shall be paid immediately after the completion of the work.

Section 36 provides provisions relating to annual remuneration increment. Any worker who has completed one year of employment service shall be entitled to receive an amount equivalent to at least half a day salary based on monthly basic salary every year as annual salary increment (grade).

Every worker shall be entitled to receive an amount equivalent to one month basic salary in a year as festival allowance for celebration of any festival based on his/her own religion, culture and tradition. A worker may give a written request to the employer for the payment of the festival allowance which he/she is entitled to receive each financial year on a major festival based on his/her religion, culture and tradition. In absence of such request, the allowance shall be provided every year at the time of Dashain festival. If any worker has not completed one year of service on the day such festival allowance is distributed, shall be entitled to receive such allowance in proportion to the length of period s/he has worked.

Deduction from Remuneration

Section 38 provides that except under the following circumstances no amount shall be deducted from the remuneration of workers:

(a) Any tax or fees levied under the existing laws,
(b) Any amount required to be contributed for provident fund and insurance or any other social security benefits,

(c) Any amount to be deducted pursuant to the order of judicial or quasi-judicial body or order of the arbitrator or decision,
(d) An amount for any specified service or facility provided by the employer to the worker,
(e) Wage for absenteeism,
(f) Amount equivalent to the book value of the goods lost or loss in cash or kind caused willfully or negligently or the amount equivalent to the production cost in relation to the manufactured goods,
(g) Amount as specified for deduction from remuneration in the collective agreement,
(h) Membership fees charged by trade unions, and
(i) Loan or payment made in advance to the worker by employer.

If a worker dies or his/her service is terminated for any reason whatsoever before the amount pursuant to this section is deducted, such amount may be recovered from any kind of amount payable to such worker by the employer or enterprise. If the amount could not be fully recovered even after all the deductions is made, the employer shall give 15 days' notice to his/her legal heir for the payment of such amount, if the worker has died. If the amount is not paid within this period, the employer may file a case in the court for the recovery of such amount within 35 days from the expiry of such period.

Leave (Holiday)

The Act has provided following types of leaves (holiday) to the workers:

(a) Weekly Holiday: Every worker shall be entitled to receive one weekly holiday in a week.

(b) Public Holiday: Every worker shall be entitled to receive 13 fully paid public holidays including May Day and 14 public holidays including International Women Day in case of women workers. If any regulatory authority that regulates any enterprise fixes the public holidays, it shall be accordingly followed. In other situations, the public holidays shall be determined by the employer.

(c) Substitute Leave: Any worker involved in the work requiring continuity shall be entitled to receive substitute holiday if he/she works during any weekly or public holiday. Such leave shall be provided within 21 days from the date of engagement in such work.

(d) Home Leave: Every worker is entitled to receive fully paid home leave at the rate of one day for 20 days for the period he/she works. Workers employed in educational institutions or workers who get summer or winter holidays shall not be entitled to take home leave However, if the number of such holidays is lesser than total number of home leave workers are entitled to, such workers shall be entitled to take shortfall number of holidays accordingly.

(e) Sick Leave: Every worker is entitled for paid 12 days sick leave annually. However, if any worker has worked for one or lesser than one year, shall be entitled to receive sick leave proportionately. Any worker seeking more than three days of sick leave continuously, may require to submit a medical certificate issued by a certified physician. If there is a need to take sick leave because of sudden illness, such worker shall inform the employer or the person specified by the employer immediately through available speedy means of communication.

(f) Maternity/Motherhood Leave

A female worker is entitled to receive a total of 14 weeks of maternity leave with a provision to take before and after the date of confinement. Such worker shall take at least two weeks leave compulsorily before the expected date of confinement, and at least six weeks leave after the date of confinement. The female worker seeking maternity leave shall be entitled to 60 days of fully paid maternity leave and for the remaining period, it shall be unpaid. If a certified physician recommends that the concerned female worker or the child need rest for his/her good health, the employer, in continuity with the maternity leave, shall give approval for one more month of unpaid leave, or with an arrangement to be adjusted with other leave in addition to the entitled maternity leave. If a female worker in a state of 7 months pregnancy or more than seven months, gives birth to a deceased child or suffers miscarriage, the provision relating maternity leave shall apply. If a mother dies before the completion of sixty days from the day her child is born, the worker whose wife has died, may take paid maternity care leave for the remaining number of days from the employer for whom he is working. Every male worker shall be entitled to 15 days fully paid maternity care leave during the confinement of his wife. Except where a newly born child dies, every female worker who takes maternity leave shall submit a copy of birth certificate to the concerned employer.

(g) Mourning (Grief/Sorrow) Leave: If a husband or wife dies or any worker himself is required to mourn (grieve) pursuant to his core religion or a married female worker is required to mourn on the death of her father/mother or father-in-law/mother-in-law, such worker shall be entitled to receive 13 days mourning leave. The worker who is on mourning leave shall be entitled to receive full pay.

Section 51 provides that all other leave except sick leave, mourning leave and maternity leave which the workers are entitled to receive are normal facilities and shall not be claimed as a matter of right. The employer may refuse, withhold, reduce or alter the time of such approved leave on the basis of the need of the work in the workplace.

5. PROVIDENT FUND, GRATUTTY AND INSURANCE

Contribution for Provident Fund

Every employer shall deduct 10 percent of the basic salary of each worker, add 100% amount equivalent to that and deposit the total amount for the purpose of provident fund. The amount for provident fund shall be deposited in the Social Security Fund in the name of the concerned worker making effective from the date such worker commences his/her job. However, the employer shall deposit the amount of the provident fund as prescribed in the following situations:

- Until the Social Security Fund is established and comes into operation, or
- Until the law relating to Social Security Fund does not become effective for the concerned employer.

Employers shall contribute the amount for provident fund from the date of the commencement of this Act for those workers for whom the provident fund contribution was not made before this Act became effective. The amount contributed for the provident fund in the retirement fund or

any other similar fund established under the prevailing laws or the amount lying under the custody of the employer before the commencement of this Act, shall be transferred to the Social Security Fund in a prescribed manner after the commencement of this Act. The Act further provides that in case the amount for the provident fund could not be deposited in the Social Security Fund as above, the employer shall pay an amount equivalent to 10% of the basic salary in addition to the actual remuneration any worker is entitled to receive.

Right to Receive Gratuity

Every employer shall deposit an amount equivalent to 8.33 % of the basic salary of each worker every month for the purpose of gratuity. The amount for gratuity shall be deposited in the Social Security Fund in the name of the concerned worker making effective from the date such worker commences his/her job.

However, the employer shall deposit the amount of the gratuity as prescribed in the following situations:

Until the Social Security Fund does not come into operation, or

Until the law relating to Social Security Fund does not become effective for the concerned employer.

Employers shall contribute the amount for gratuity from the date of the commencement of this Act for those workers for whom the gratuity contribution was not made before this Act became effective. The amount contributed for the gratuity in the retirement fund or any other similar fund established under the prevailing laws or the amount lying under the custody of the employer before the commencement of this Act shall be transferred to Social Security Fund in a prescribed manner after the commencement of this Act. The Act further provides that in case the amount for the gratuity could not be deposited in the Social Security Fund as above, the employer shall pay an amount equivalent to 8.33% of the basic salary in addition to the actual remuneration any worker is entitled to receive.

Provision on Medical Insurance and Accidental Insurance

Every employer shall make a provision for annual medical insurance of at least Rs. 100,000 for every worker. The premium required for the medical insurance shall be shared by both the employer and worker equally.

Every employer shall make a provision for accidental insurance of at least Rs. 700,000 covering all kinds of accidents for every worker. The total premium required for the accidental insurance shall be borne by the employer. If a worker dies or is completely incapacitated mentally or physically as a result of an accident, such worker or his/her legal heir pursuant to the prevailing law shall receive 100 % amount of the insured sum as compensation. In case a worker is injured or incapacitated in an accident, compensation shall be provided in accordance with the percentage prescribed in proportion to the injury or incapacity caused.

Applicability of Social Security Scheme

Any employer or worker making contribution in the Social Security Scheme for the provident fund, gratuity and medical insurance benefits pursuant to the laws relating to Social Security

Fund shall not be required to make additional contribution or subscribe insurance policy under this Chapter to that extent.

6. PROVISIONS RELATING TO LABOUR SUPPLY

The Act has introduced provisions on 'labour supplier'. Previous Act of 2048 was silent on this matter. The Act has defined labour supplier as any company having a license to supply workers to the main employer. 'Main Employer' means an employer who employs workers through a labour supplier. On recommendation of the Central Labour Advisory Council, the Ministry may publish, through a notification in the Nepal Gazette, a list of services in which workers may be hired from labour supplier.

Any company desirous of taking a license shall submit an application in the prescribed format along with fees, details and documents as specified to the Office of the concerned area. However, any company interested to supply workers in the area having more than one Office shall submit such application to the Department. The Department or Office shall take a deposit or bank guarantee as prescribed and issue a license to such applicant in a specified format along with conditions within 15 days from the date of receipt of the application if satisfied with the application after examination. Any employer, while hiring workers through labour supplier shall employ them in any work other than the core work of such business or service.

Responsibilities of Labour Supplier

- Labour suppliers shall not act in violation of the conditions or directions as prescribed under this Act or the rules made under this Act.
- Every labour supplier shall provide remuneration and other benefits regularly to the workers it supplies and such benefits shall not be lesser than those determined by this Act in the capacity of an employer under this Act.
- Labour suppliers shall be responsible for regularly acquiring the information on Occupational Safety and Health provisions or arrangements required to be adopted in the work place by the main employer. If the workplace lacks such provisions, the labour supplier shall recommend the main employer to make such arrangement immediately. If the main employer fails to implement the recommendation, the labour supplier shall inform the Department or the Office accordingly.

Cancellation of License, Suspension or Fines

If the labour supplier has not been complying the conditions and directions issued pursuant to this Act or the rules made under this Act, the Department or Office, for the first time, may impose a fine up to Rs. 25,000 to any labour supplier. If the labour supplier continues to violate such conditions, the Department or Office responsible for the issuance of license may cancel the license of such labour supplier. An opportunity shall be given to the concerned labour supplier for the submission of an explanation at least 7 days before the cancellation of the license. The Department or Office may cancel the license of labour supplier, if it files a written application for the cancellation of the license. The decision to cancel the license shall be informed through public notification.

Labour supplier shall pay the amount of remuneration and other benefits to the concerned workers within 15 days from the date of cancellation of license. On failure to pay the amount of remuneration and other benefits within the prescribed period, the concerned Department or Office responsible for the issuance of license shall arrange the payment of such amount to the workers from the deposit or bank guarantee given by such Labour supplier at the time of acquiring the license. If the amount of deposit or bank guarantee becomes insufficient for the payment of remuneration and other benefits, the payment shall be made proportionately. In case such labour supplier is liquidated or dissolved, the remaining remuneration and other benefit which is due after making the payment proportionately shall be made in accordance with the prevailing law. If the labour supplier is continuing other activities without being dissolved or liquidated, the Office may give an order for the payment of such remuneration and benefits from its other properties.

Liabilities of the Main Employer

- Any main employer, when employing workers through a license holding labour supplier, shall follow an agreement entered with such labour supplier.
- Main employer, before entering into an agreement, shall ensure that the provisions for the payment of remuneration and benefits to the workers shall not be lesser than prescribed by the Act or the rules made under the Act.
- Main employer shall acquire regular information on whether the labour provider is regularly providing remuneration and benefits to the workers hired from such labour supplier or not. On inquiry of the information, if it is found that the remuneration or benefits are not provided to the workers by the labour supplier, the main employer shall immediately make a request to such labour supplier for the payment of such remuneration and benefits, and the Department or Office shall also be informed accordingly.
- The main employer shall make necessary means and arrangement relating to the Occupational Safety and Health required to be complied in the workplace.

If the remuneration and benefits to be provided pursuant to the prevailing law increases after an agreement between a main employer and a labour supplier is made, such amount of remuneration and benefits, to the extent of increment, shall also be paid by the main employer.

7. OCCUPATIONAL SAFETY AND HEALTH

The safety of workplace is an essential component of efficiency and productivity. In a working environment, one must be able to ensure that the worker have been provided with required safety equipment. Most often, it is the labor in developing countries that faces the brunt of the safety problems. At times their safety is ignored and even when safety tools are given, they can often be obsolete. Amongst other fields, the industrial sector is often the one that requires the most attention in this area.

Illness or accident to a worker has far reaching consequences. While the employer loses out on a worker who is accustomed to his/her job. The employee also pays the price with multiple problems within and outside their family. There are employers who try to do better whereas many of them have not met the minimum standard. It is in such workplaces that government must intervene to ensure safety and standardize the safety measures across the board.

Considering the importance of safety and health, Section 68 provides that every employer shall formulate a policy on safety and health of workers and other persons in the workplace and implement it, subject to the provisions of this Act, the rules made under the Act and directions issued pursuant to the Act and rules. The policy shall be registered in the Office. The Office shall regularly monitor whether the safety and health policy formed by the employer is complied or not.

Formation of Safety and Health Committee

Every employer having 20 or more workers, including workers hired through labour supplier in any enterprise shall constitute a Safety and Health Committee comprising of representatives of workers as well in the manner as prescribed. The functions, duties and powers of the Safety and Health Committee shall be as follows:

- To give advice to the employer regularly on the kind of arrangement to be made on the safety and health of workers and its effectiveness,
- To evaluate the arrangement made on the safety and health in the workplace and draw the attention of the employer for making it more effective and to inform the Office if the work is not done by the employer.
- To review the Safety and Health Policy every year,
- To perform other functions as prescribed.

Duties of Employers towards Workers

Duties of employers towards workers in respect of Occupational Safety and Health shall be as follows:

- Ensure safe environment by making appropriate safety and health provisions at the workplace,
- Make necessary provision for the use, operation, storing or shifting of chemical, physical or biodegradable (decomposable) material or equipment so that the safety and health of workers are not affected adversely,
- Provide necessary information, notice or training relating to the safety and health to workers,
- Provide necessary training & information in an appropriate language to workers in relation to equipment and use or operation of chemical, physical or biodegradable material for the work,
- Make proper arrangement for the safe entry and exit from the workplace,
- Provide necessary personal safety equipment to workers,
- Make other provisions as prescribed

Duties of Manufacturers, Importers and Suppliers

Following shall be the duties of manufacturers, importers and suppliers of equipment or material used in the workplace:

- To manufacture, import or supply equipment, products or material found suitable from the examination for the operation and use in the workplace from the viewpoint of safety and health,
- To determine suitable method or process of using or operating such equipment, products or material so that the safety and health of the concerned workers is not affected adversely,

- To identify possible risks of causing adverse effect on the safety and health of workers by the use of such equipment, products or material,
- To conduct necessary research, experiment or test to eliminate or minimize the risks of causing adverse effect on the safety and health of workers,
- To prepare a manual in order to provide all the information relating to necessary steps required to be taken during the operation and use of equipment, products or material from the viewpoint of safety and health.
- To ensure by giving a report in writing that such equipment manufactured or installed for the use of the workplace, if used properly, will not be harmful to the safety and health of workers.
- To provide chemical Safety Data Sheet by manufacturer, importer or supplier of any chemical material to be used in the workplace relating to such material including other details as prescribed to the employer.

Duties of Workers in Relation to Occupational Safety and Health

Duties of workers in relation to Occupational Safety and Health shall be as follows:

- Not to perform any act intentionally or carelessly that may cause adverse effect or risk on his/her own safety and health of others,
- Provide necessary cooperation to the employer or any other concerned person for the fulfillment of duties mentioned in this Chapter,
- Acquire information about the manual, instruction or other matters prepared for the operation or use of the equipment, products or material safely and cautiously in the workplace,
- Operate or use the workplace, equipment or products or material safely and cautiously (carefully) by following the manual, instruction or other matters prepared for the operation or use of such workplace, equipment, products or material,
- Use the personal safety equipment provided by the employer compulsorily.

8. PROVISIONS RELATING TO SPECIAL TYPES OF INDUSTRIES AND SERVICES

A. Special Provisions Relating to Tea-estate Workers

Duties of employers towards tea-estate workers shall be as follows:

- Make an arrangement for suitable quarters within tea-estates for workers who do not have their own houses nearby,
- Make provision for a trained medical staff, medical items including medicines and free first aid service for the treatment of minor injuries sustained by workers and their dependent family members,
- Make an arrangement for an easy availability of daily necessities by workers and employees in case there is no market near by the tea-estate,
- Make an arrangement for sports and entertainment for physical and mental development of the workers and their dependent family members.

For the purpose of this section:

(a) "Tea estate" means tea estate registered pursuant to prevailing laws and this term also includes factory, other physical structures established inside the tea estate and its premises.
(b) "Worker of tea estate" means any person who carries out the work of digging, ploughing, leveling, cutting, plucking, scattering, sowing, collecting, uprooting and other similar kinds of work in the tea estate and it shall also include any person engaged in tea processing and other related works.
(c) "Dependent family members" means family members who live with a tea-estate worker and whom s/he has to take care for their livelihood.

B. Special Provisions Relating to Construction Workers

Any person or organization taking responsibility for construction work or contract shall be deemed to be an employer for the purpose of this section. When fixing the rate of wage and other benefits for construction workers, representation of the concerned trade union and Contractors' Association shall be compulsory. Duties of employers towards construction workers shall be as follows:

- Provide necessary tools and material in sufficient number and quantity required for the construction,
- Make arrangement for temporary quarters, clean drinking water and supply of necessary food items to workers who do not have houses nearby the construction site,
- Make necessary safety arrangement at the construction site.

For the purpose of this section,

(a) "Construction work" means construction of building, road, bridge, canal, tunnel, internal or interstate waterways or railways or construction of power station, telecommunication or telegraphic stations and construction of other similar structures and the word shall also include installation of related equipment, tools or machines in those structures;
(b) "Construction worker" means any worker who is engaged in construction work.

C. Special Provisions Relating to Transport Workers

Duties of employers towards transport workers shall be as follows:

- There must be a compulsory provision of, at least, two drivers in the vehicles that operate in a long route with an arrangement to drive turn by turn,
- An arrangement shall be made for taking rest in different places for the drivers of vehicles operating in the long route before reaching at the final destination,
- If the workers of the transportation service are required to work more than eight hours a day, they must be paid remuneration at the rate of 1.5 times of their ordinary rate of remuneration. Provided that, if the workers are paid any trip allowance, food allowance or any other allowance of similar nature, they shall be entitled to receive either the overtime payment or these allowances as per their choice,
- If any vehicle breaks down before reaching the final destination or is required to be stopped in one place for any reason, workers of such vehicle shall be paid only fifty percent of the allowances they are entitled to receive,
- Necessary medicines and medical treatment items for first aid shall be kept in the vehicles.

Workers engaged in driving shall not consume alcohol or drugs at least 12 hours before driving the vehicle until the final destination is reached. If any worker does so, it shall be deemed to be misconduct and the concerned worker may be dismissed from the job by the concerned employer. However, an opportunity of hearing shall be provided to the worker before dismissing him from the service.

If it is necessary to terminate the service of any worker due to the sale of the vehicle or change of ownership of the vehicle, the employer may do so by providing the benefits relating to termination of employment. Provided that, this provision shall not be applicable for enterprises operating vehicle.

For the purpose of this section,
(a) "Long Route" means a long route as determined pursuant to the law.
(b) "Transportation work" means any work relating to the transportation of people, animal or goods from one place to another with the help of mechanical means.
(c) "Transportation worker" means any worker engaged in transportation job.

D. Special Provisions Relating to Tourism Workers

Duties of employers towards tourism workers shall be as follows:

- Provide sufficient quantity of medicine and medical treatment items for first aid when sending workers to the workplace,
- Rescue or cause to rescue any worker in case of an accident or serious health problem.

The tourism worker shall be provided either field, food and other similar allowances or remuneration at the rate of 1.5 times of the ordinary remuneration for working extra time as per his/her choice between these two benefits, when working in the workplace (field). Employers operating any hotel, motel, restaurant, jungle safari or any other similar kind of business shall distribute service fees collected pursuant to collective bargaining as prescribed.

E. Provisions Relating to Domestic Workers

The Government of Nepal may fix minimum wage for domestic workers separately. Notwithstanding anything contained in this Act, provisions relating to public holiday, weekly holiday and related matters for domestic workers shall be as prescribed. If an employer makes an arrangement for food and shelter at his house itself or provides financial assistance for the education of a worker, such expense may be deducted from the remuneration of such worker. Every domestic worker shall be allowed to celebrate festival pursuant to his/her culture, religion or tradition by the employer.

F. Provisions Relating to Seasonal Enterprises

For the purpose of this section, "seasonal enterprise" means any enterprise that can be operated in a particular season only and it also includes an enterprise which cannot be operated for more than 180 days in a year. Workers of any seasonal enterprise shall be kept in reserve during the period of closure in off season. Notwithstanding anything contained in this Act, during the closure of any seasonal enterprise in off season, the workers in regular employment shall be paid

at least 25 percent of their remunerations which they are entitled to receive. The office shall decide as to a question whether any enterprise is a seasonal enterprise or not.

9. PROVISIONS RELATING TO INSPECTION

Government of Nepal may establish Labour Offices as required for the enforcement of this Act and other prevailing laws relating to labour. The Ministry shall fix the districts that fall within the jurisdiction of the established labour offices. The Government of Nepal may appoint one or more inspectors for any area as per the need through notification in the Nepal Gazette. The Act defines "inspector" as senior labour inspector, labour inspector, senior occupational safety and health inspector and occupational safety and health inspector and it shall also mean other employees deputed for inspection.

Functions, Duties & Powers of the Office

The Functions, duties and powers of the Office shall be as follows:

- To carry out inspection & find out whether minimum wage fixed pursuant to this Act, allowances & benefits entitled to receive pursuant to collective agreement or rights given to employers & trade unions by the prevailing laws are enforced or not,
- To conduct regular inspection to find out whether this Act or rules made under this Act are being effectively enforced or not and give necessary direction to the concerned party for their enforcement,
- To conduct trainings on standards or codes of conduct as formulated pursuant to this Act or any other prevailing laws and carry out regular inspection to find out whether they are enforced or not,
- To provide necessary technical support to the employers & trade unions if they seek such support for conducting necessary trainings,
- To give direction to employers to produce occupational safety and health standards or employee rules or other related documents,
- To enforce collective bargaining agreement entered into between employers and workers or decision of the mediator,
- To inspect and find out whether children are being employed or not and immediately rescue the children if found employed and take action against such employer accordingly,
- To carry out inspection to find out whether the employer has implemented the provisions relating to occupational safety and health for any enterprise or workplace or not,
- To observe and inspect the equipment installed in the workplace, tools, apparatus or objects or material & examine whether such equipment, tools or objects or material is of prescribed standard or not and if the test is required, collect samples of the same,
- To conduct or cause to conduct periodic or immediate inspection in the enterprise or workplace,
- To give an order to the concerned enterprise or the officers of such enterprise to produce electronic record including register or written documents & if they are not provided, take control of original register or written documents by entering into such enterprise,
- To collect required information from the employer, managers and other workers of the enterprise,

- To seek explanation from the employer, managers or other workers by summoning them to the office if necessary,
- To give necessary direction for rectification in case any information is received during the inspection of the workplace or enterprise or from any other source in relation to any activity performed in violation of the Act or the rules made under this Act by the employer or worker or trade union,
- To keep the record of application or documents or any notice received from any other source in the Office or give evidence of the registration of such application or documents or keep the record of the decision, order or compromise or give certified copy of any document if requested,
- To carry any other functions specified by this Act or other existing laws to be executed by the Office,
- To carry out any other functions as may be prescribed.
- To request the local administration, the police or any other concerned body to provide assistance in case it is necessary for using powers given under this section.

Functions, Duties & Powers of Inspectors

Execution of the functions, performance of the duties and use of the powers for the Office shall be carried out by the inspectors and employees working under them in the prescribed manner. The occupational safety & health inspectors shall have the powers to carry out those functions that have been clearly entrusted to the occupational safety & health inspectors by this Act or any other laws or inspection of factory machinery and equipment or occupational safety & health matters or any other technical function for the Office. However, nothing contained in this section shall act as a constraint for any office in employing any occupational safety & health inspector from another Office or any technical person having knowledge on occupational safety & health for inspection in case the office lacks occupational safety & health Inspectors. The labour inspector may also act accordingly.

Responsibility of inspectors or employees deputed to inspect enterprises and workplaces shall be as follows:

- To enter any enterprise or workplace only after showing identity card,
- To provide receipt while taking control or seizing any register, written documents, records or objects,
- To keep the identity of any complainant confidential if s/he request to do so,
- To fulfill duties without creating any obstruction in the work of the enterprise or workplace,
- To keep all notices, information and data acquired during inspection confidential unless they need to be disclosed under the requirement of the law.

If an inspector or employee deputed to inspect any enterprise or workplace fails to fulfill the duties provided as above or acts disrespectfully or acts against the position or causes loss by doing an act with a wrong intention, the concerned person shall inform the competent authority through the Office. The competent authority may take departmental action pursuant to the prevailing law if the inspector or employee is found guilty in the investigation.

The inspector or employee shall submit a report with details as prescribed to the Office within 15 days from the date of completion of the inspection of the enterprise or workplace, unless otherwise directed. On receipt of the report, if the Office, after conducting a proper examination, feels the need for an improvement in relation to any work, working procedure or any other matter of the enterprise or workplace or worker or trade union, the office may give a direction for improvement or stop any act that is being carried out in contravention to the law. The party dissatisfied with the direction issued by the Office may file appeal in the Labour Court within 35 days from the date of issuance of such direction. The decision of Labour Court in relation to the appeal shall be final.

Labour Audit

Labour Audit is one of the fundamentals to correct the imbalance of power between the employee and the employer by protecting their various rights. Like any financial audits that are undertaken annually to evaluate financial status of an employer, labour audits provide a systematic means for employers to determine their exposure to employment lawsuits and to minimize potential liability by taking preventive action. Provision of labour audit is thus introduced to determine the employee's attitude towards the employer, to identify possible areas of vulnerability and to review the compliances of the employer's policies and procedures along with the prevailing local labour laws.

Section 100 provides that every enterprise, after conducting a labour audit in relation to the compliance of the Act, Rules and any other prevailing law as prescribed, shall prepare a report accordingly. The labour audit report shall be submitted to the Office or inspector if asked during inspection carried out under this Chapter or if demanded, at any other time.

The Labor Audit should be conducted as per the criteria defined by the Ministry of Labor. Using the power conferred by Rule 56, the Ministry of Labor, Employment and Social Security has issued the Labor Audit Standard, 2018. The Labor Audit Standard has come into implementation effective from November 22, 2018. The Labor Audit Standard has prescribed the specific factors that are to be taken into consideration while conducting the Labor Audit. Pursuant to the Standard, while conducting the Audit, the Labor Auditor must ensure that the Enterprises have implemented the provisions of followings:

- Labor Act, 2017 and Rules, 2018,
- Social Security Act 2017, and Rules 2018,
- Bonus Act 1973, and Rules, 1982,
- Trade union Act 1992, and Rules, 1993,
- Matters included under Audit Report pursuant to Schedule 10 of Labor Rules,
- Internal rules and byelaws of the Enterprise,
- Other relevant issues.

10. PROVISIONS RELATING TO COUNCIL AND COMMITTEES

Formation of Central Labour Advisory Council

Section 102 provides that a Central Labour Advisory Council, for the purpose of giving advice on labour matters to the Government of Nepal, shall be established as follows:

(a)	Minister or State Minister of Labour and Employment	Chairman
(b)	Secretary, Ministry of Finance	Member
(c)	Secretary, Ministry of Labour and Employment	Member
(d)	Secretary, Ministry of Physical Infrastructure and Transportation	Member
(e)	Secretary, Ministry of Agriculture Development	Member
(f)	Secretary, Ministry of Industry	Member
(g)	Secretary, Ministry of Health	Member
(h)	Director General, Department of Labour	Member
(i)	Executive Director, Social Security Fund	Member
(j)	Executive Director, Vocational Skill Development Training Centre	Member
(k)	Minimum f 5 persons including 2 women from among employers nominated as prescribed by the Ministry	Member
(l)	Minimum 5 persons including 2 women from among TtradeUnion Federation nominated as prescribed by Ministry	Member
(m)	Joint Secretary, (Responsible for the concerned Division), Ministry of Labour and Employment	Member-Secretary

The tenure of the members nominated pursuant to (k) and (l) above shall be for 3 years and may be re-nominated after the expiry of the tenure. The Ministry shall nominate such members on the recommendation of employers' associations, in case of employers and Joint Trade Union Coordination Centre, in case of trade union federations. The members nominated under (k) and (l) above may nominate alternative members for participation in the meetings of the council in their absence.

Section 105A provides that Province Government may form Province Labour Advisor Council to make easy for the implementation of this Act and to make reforms in labour areas at Province level. The provisions relating to formation, operation and other issues of Province Labour Advisor Council shall be as prescribed by Province Government.

Functions, Duties & Powers of the Council

The functions, duties and powers of the Council shall be as follows:

- To provide advice and suggestions in relation to labour policies to the Government of Nepal,
- To provide necessary advice and suggestions to the Government of Nepal for appropriate improvement in the laws relating to labour,
- To provide suggestions to the Government of Nepal in relation to the ratification (endorsement) or implementation of any international convention concerned with labour of which Nepal is a party,
- To provide suggestions to the Government of Nepal in relation to the report concerning any international convention on labour which it is required to submit,

- To provide suggestions to the Government of Nepal in relation to the formulation of policies concerning vocational skill development training,
- To prepare standards on Occupational Safety and Health and recommend it to the Government of Nepal,
- To prepare code of conduct on fair labour practice and recommend it to the Government of Nepal,
- To set up necessary coordination with the Government of Nepal, employers and trade unions for the purpose of establishing industrial peace, sound industrial relation and minimization of disputes,
- To set up necessary coordination with the Government of Nepal, employers and trade unions for the purpose of employment and productivity growth,
- To frame and issue directive on collective bargaining as required, and
- To perform other functions as prescribed.

The Council may form required number of committees or taskforce for the purpose of carrying out its functions. The functions, duties and powers of the committees or task force shall be as prescribed at the time of formation by the Council. A secretariat of the Council shall be located at the Ministry.

Meetings, Quorum and Decisions

Meetings of the Council shall be held as required on the date, place and time fixed by the Chairperson of the Council However, the difference between two meetings shall not be more than four months. The Chairperson shall call a meeting within 15 days if one fourth of the total number of members of the Council submits a written request for such meeting. Member-Secretary of the Council shall circulate a notice along with the agenda of the meeting to all the members at least 24 hours before such meeting is scheduled. Presence of more than 50% of the total number of members represented by the government, employers and trade unions in the meeting of the Council shall constitute the quorum.

The Chairperson of the Council shall preside the meeting of the Council and in his absence, the Secretary of the Ministry shall preside the meeting. A labour expert may be invited in the meeting of the Council. Decisions in the meeting of the Council shall be taken on the basis of consensus. In case the consensus is not reached, the decision shall be taken on the basis of the majority of the members representing the government, employers and trade unions. There shall be a separate minute book for recording the decisions of the meeting and such decisions shall be authenticated by the Member-Secretary of the Council. Other procedures concerning the meeting of the Council shall be as determined by the Council itself.

Minimum Wage Fixation Committee and Fixation of Minimum Wage

Section 107 provides, the Ministry shall constitute a permanent Minimum Wage Fixation Committee consisting of representatives from the Government of Nepal, Trade unions and employers' associations for the purpose of recommending minimum wage to the Ministry in the prescribed manner. The committee when recommending minimum wage for workers, may do so for the whole country or specific region or specific nature of enterprises or industries or

employment sector. Grounds for the recommendation of minimum wage shall be determined by the Committee itself. The Committee shall commence the process of reviewing the minimum wage from the month of Baisakh in every two years

The Ministry shall fix minimum wage for workers every two years on the recommendation of Minimum Wage Fixation Committee. The Act has provided power to the Ministry to fix minimum wage in case the Minimum Wage Fixation Committee fails to recommend the minimum wage due to lack of consensus. The minimum wage fixed by the Ministry shall be published in the Nepal Gazette. The minimum wage fixed shall be effective from the 1st day of new fiscal year. However, if any agreement is entered between a trade union and employer concerning the effective date for the implementation of the minimum wage, it shall be followed accordingly. When fixing minimum wage in accordance with other prevailing laws of Nepal, the fixation of such minimum wage lesser than the wage fixed pursuant to this Act is prohibited.

11 INTERNAL MANAGEMENT OF ENTERPRISES

Internal management of enterprise is an important tool for smooth operation of the enterprise. Thus, section 108 provides that every enterprise may make a by-law as required for the purpose of its internal management. When making a by-law for employment conditions and benefits of workers, the enterprise shall do so without violating the minimum standard prescribed by this Act and collective agreement. The Ministry may make a model (sample) by-law as required. However, it shall not be a constraint for Nepal Rastra Bank, in case of banks and financial institutions and any other competent regulatory authority, in case of any other enterprise, to make by-law as required. One copy of the by-law made by the enterprise shall be registered in the Office and it shall be made available to workers if they desire to see it. Any enterprise shall consult the authorized trade union if there is any or in its absence, any other active trade union of the enterprise when making or amending byelaw. If any provision of the by-law made by the enterprise contradicts with this Act, prevailing laws or collective bargaining, the court may declare such provision null and void or give any appropriate order.

Labour Relation Committee

Employer of every enterprise having 10 or more workers shall form a Labour Relation Committee as prescribed. Meetings of the committee shall be held as required without affecting the work of the enterprise. The functions, duties and powers of the committee shall be as follows:

- To hold consultation for productivity increment and improvement of the operating system,
- To make an effort to settle any grievance (complaint) or any probable grievance of workers in consultation with the concerned party,
- To improve environment of the workplace,
- To work in the capacity of Occupational Safety and Health Committee until it is formed,
- To perform other functions as prescribed.

Transfer of Workers

Enterprise may transfer a worker from any of its office, branch or unit to another office, branch or unit without causing any adverse effect on the existing employment conditions and benefits as

well as without causing any difference in his/her nature of work or level. However, transfer may be carried out in spite of difference in the nature of work as well as level in the following situations:

- With the consent of the concerned worker,
- Placement in a new position through promotion,
- As mentioned in the collective agreement,
- Act of transferring to any other position suitable to training or skill or educational qualification acquired by the worker.

Any worker employed in one enterprise may be transferred with his/her consent to another enterprise. When transferring any worker as such, an agreement between the enterprise which is transferring and the enterprise where the worker is being transferred shall be entered into, regarding the issue of taking the liability of adding the service period and employment conditions and benefits for such period of the worker by the recipient employer. When transferring any worker from the workplace located in the place of his/her permanent residence or to any other place from the regular workplace, the employer shall provide benefits as prescribed.

Performance Evaluation of Workers

Enterprise may normally carry out performance evaluation of workers once in a year.The basis and procedure for work performance evaluation shall be determined on the basis of reasonability and judiciousness and shall be notified to workers before the time for the work performance evaluation is commenced. On completion of the performance evaluation, the employer or the person designated by him/her shall consult with the concerned worker in relation to his/her strength and weakness and give a reasonable opportunity to improve the weaknesses. If a worker disagrees with the result of the performance evaluation, such worker shall be provided an opportunity to clarify the points of disagreement and shall be required to sign the evaluation form accordingly.If a worker is dissatisfied, the enterprise shall accordingly make a provision for appeal.

12. SETTLEMENT OF INDIVIDUAL DISPUTE

In industrial relations 'dispute' indicates differences between workers and the management over the issues related to their rights and interests. The causes and issues of disputes may be wages/salary, staff retirement, union recognition, leave, working hours, indiscipline, working standard, working conditions, etc. Individual claim/dispute means a claim of a particular worker. The Labour Act has laid down the following procedures for the settlement of individual claim:

Submission of Claim

Section 113 provides that any worker having an individual claim concerning any matter relating to the right entitled under this Act, the rules, prevailing laws or collective bargaining may submit an application in writing to the employer. The employer shall give acknowledgment of the claim received in writing. The employer shall settle the dispute relating to the claim within 15 days after consultation with the concerned worker. The time for the settlement of dispute may be extended through consent between the employer and the concerned worker.

Filing of Application to the Office

Section 114 provides that any concerned party may submit an application to the Office for the settlement of dispute under section 113 through mediation in the following situations:

- If the employer does not give any notice for consultation within 7 days from the date of submission of the application by the worker, or
- If an agreement could not be reached after the consultation held between the employer and the worker and 15 days from the date of submission of application to the employer has elapsed.

After receipt of the application, the Office shall notify the date and time to the employer and the concerned worker for consultation. The Office shall settle the dispute relating to the claim within 21 days from the date of the receipt of the application by holding consultation as required between the employer and the concerned worker. The time for the settlement of dispute may be extended through consent between the employer and the concerned worker. If an agreement is reached between the employer and the worker in the consultation, such dispute relating to the claim shall be deemed to have been settled. The agreement shall be binding to both the parties.

The Act has also given power to the Office for the settlement of the dispute. If the dispute does not get settled pursuant to section 114, the office shall give decision within 15 days on the basis of evidences.

13. SETTLEMENT OF COLLECTIVE DISPUTE

Submission of Collective Claims or Demands to Employer

Section 116 provides that any enterprise employing 10 or more workers shall have a Collective Bargaining Committee as follows:

(a) A team of representatives appointed for negotiation on behalf of the elected authorized trade union of the enterprise,

(b) If an election for the authorized trade union pursuant to point (a) could not be held or the term of the elected authorized trade union has expired, a team of representatives nominated through a mutual agreement of all the unions in the enterprise,

(c) If an authorized trade union pursuant to point (a) or a team of representatives pursuant to point (b) could not be formed, a team of representatives supported with the signatures of more than 60% of the workers working in the enterprise.

Collective Bargaining Committee may submit collective claims or demands in writing to the employer on issues relating to the interest of workers. On the basis of the number of workers, Collective Bargaining Committee may have three to eleven members. Collective Bargaining Committee shall have the power to submit collective claims or demands, enter into agreement, file a case against any person or defend in such case. The Act prohibits submission of collective claims or demands on the following matters:

- That is contrary to the Constitution of Nepal,
- That may adversely affect the interest of any other person because it is based on groundless allegation without any proof,

- Any matter which may affect the personal behavior of any employer or worker,
- Matter which is not related to the enterprise,
- Matters in which a collective agreement has been made and the period specified in the Act for such agreement has not expired yet,
- Matters relating to contribution rate and benefits specified for social security schemes.

On submission of collective claims or demands as above, the concerned employer shall give a notice in writing to the Collective Bargaining Committee within seven days from the date of submission of such claims or demands stating the place and time for the consultation. Members of the Collective Bargaining Committee shall be present for consultation at the place and time stated in the notice. The dispute relating to the collective claims or demands shall end if any agreement between the concerned two parties is achieved and the agreement shall be binding for both the concerned parties.

Settlement of Dispute through Mediation

Section 118 provides that the concerned party may give an application to the Office for the settlement of collective bargaining claims or demands through mediation in the following situations:

- If an employer fails to give any notice to the Collective Bargaining Committee for consultation within seven days from the date of submission of such claims, or
- If an agreement could not be reached in the consultation held between the employer and Collective Bargaining Committee within 21 days from the date of submission of claims or demands.

On receipt of the application for mediation, the office shall call both the concerned parties and resolve the dispute through mediation. The proceeding of mediation shall be completed within 30 days from the date of application for mediation in the Office. However, the time may be extended through consent of the parties in case there is continuity in the negotiation. The dispute relating to the collective claims or demands shall end if any agreement between the concerned two parties is achieved in the negotiation held in presence of the Office. The agreement shall be binding for both the concerned parties.

Settlement of Dispute through Arbitration

Section 119 provides that if the dispute is not resolved through mediation under section 118, dispute relating to the collective claims or demands shall be settled through arbitration in the following circumstances:

- If the Collective Bargaining Committee and the employer agree to settle the dispute relating to collective claims or demands through arbitration,
- If a collective dispute arises in an enterprise providing essential service. Essential service means any service, if interrupted, may have an adverse effect on the life, health and safety of the people of the entire country or the people living in any part of the country.
- If a collective dispute arises in an enterprise located inside the special economic zone, or
- If a situation where strike is prohibited due to imposition of emergency according to the Constitution arises.

If the Ministry has a ground to believe that a financial crisis may take place in the country as a result of ongoing or possible strike or lockout or believes that the dispute needs to be settled by arbitration, the Ministry may give an order for the settlement of the dispute through arbitration, irrespective of the state of the collective dispute. For the purpose of settlement of dispute through arbitration, the Ministry shall form an arbitration panel ensuring representations from workers, employers and the Government of Nepal. Expenses for the formation of arbitration panel shall be borne by the Government of Nepal.

Any party desiring to settle the dispute through arbitration shall submit claims in writing to the arbitrator/s. On receipt of the claims, the arbitrator/s shall send a copy of such claims to the other party and provide an opportunity to such party to file a written statement in response to the claim. The arbitrator/s may consult or take an advice from an expert in initiating the arbitration proceedings. The arbitrator/s shall have power as that of any court under the prevailing laws to take evidence into record, examine witnesses, inspect sites and other related work in connection with the proceeding. Hearing shall be conducted by the arbitrator/s on the specified date, time and place and the arbitration proceeding shall not be stopped simply on the ground that the other party has failed to be present or a written statement has not been filed. The arbitrator/shall deliver the decision within 30 days from the date of ending of the hearing.

Right to Strike for Settlement of Collective Dispute

"Strike" means a situation where workers collectively refuse to perform their regular work partially or completely. However, it shall not mean the act of staying on leave or stoppage of work as a result of immediate danger or inability to attend or execute the work due to situations beyond the control of workers. A Collective Bargaining Committee may organize strike for the settlement of collective dispute if any of the following situations prevail:

- If no condition exists for compulsory arbitration under section 119(1),
- If an arbitrator/s does not perform the functions of arbitration,
- If an arbitration panel could not be formed within 21 days from the date of application in the Ministry or decision is given against the need for such arbitration,
- If a decision is not given by arbitrators within the prescribed time,
- If the employer refuses to enforce the decision of arbitrators or challenges such decision on legal grounds,
- Except where compulsory arbitration is to be adopted, if any party dissents with the decision given by the arbitrator/s under section 122(2).

In order to organize a strike, a written notice along with claims or demands and the date from which the strike is to commence shall be submitted to the employer 30 days before organizing such strike and the Office of the Local Administration as well as concerned Labour Office shall also be informed accordingly. Notwithstanding anything contained elsewhere in the Act, even in situations where the notice of strike is given or the strike is commenced, it shall be withheld and take part in the arbitration process, if the Ministry issues an order to settle the dispute through arbitration. The Act has prohibited the workers deputed as watchmen or guards for the security in any enterprise to get involved in strike during the time they are assigned in the work and take part in picketing (protesting) and mass assembly.

Right to Lockouts

"Lockout" means the closure of any enterprise or workplace by an employer prohibiting its workers from carrying out their regular work partially or completely. However, the word shall not mean a situation where workers are laid off or the stoppage of work because of an immediate danger.

If a strike is organized without giving a notice pursuant to this Act or continues the strike or collective dispute could not be settled through the procedure prescribed in the Act, the management may by giving justifiable grounds lockout the enterprise after acquiring approval from the Department. Before carrying out lockout, the management shall issue a notice of at least seven days along with a date for the lockout to the workers in case they do not end the strike.

If there is a possibility of causing loss to the enterprise because of 'gherao', physical unrest or any such type of act by the workers during the period of strike, the management may lockout the enterprise and sent notice along with justifiable reasons regarding such lockout to the Office or Department or Office of the Local Administration within 3 days. On receipt of the notice of lockout, the Office of the Local Administration shall immediately make necessary security arrangement in the workplace.

The Department may at any time declare the lockout of any enterprise illegal in case it appears unjustifiable or it is likely to disturb the peace and security of the country or it is likely to cause adverse effect on the economy of the country. The Act prohibits lockout in the enterprises providing essential services.

Provisions Relating to Picketing (Protesting) and Mass Assembly

The workers may organize picketing or mass assembly at the gate of the workplace or enterprise peacefully with the objective of exerting pressure to fulfill the claims or demands when the strike or lockout is continuing. In situations of other than strike or lockout, workers may organize picketing or mass assembly before or after the working hours or during the rest time without disturbing the work in the workplace or enterprise. The workers shall not be permitted to do any act of prohibiting others from entering or leaving the workplace or enterprise or causing damage to the workplace during picketing or mass assembling.

Remuneration for Strike and Lockout Period

Workers shall not be entitled to receive remuneration for the period of strike if such strike is organized in contravention to the prevailing laws. Workers shall be entitled to receive full remuneration for the period of lockout if such lockout is organized in contravention to the prevailing laws by the employer. Except otherwise agreed in relation to the payment of remuneration in the collective agreement, workers shall receive half remuneration for the period of strike or lockout organized in compliance with the procedure prescribed in this Act. If any dispute in relation to the legality of strike or lockout arises, the Department shall settle the dispute within 35 days after conducting necessary inquiry.

14. FAIR LABOUR PRACTICE, CONDUCT AND PUNISHMENT

Employer, Enterprise and Trade union shall observe fair labour practice in their conduct with each other in carrying out their activities. Any of the following acts done by employers shall be deemed to be unfair labour practice:

- Act of not complying with the laws related to labour or cause others to do so,
- Act prohibiting the use of any of the rights conferred by the labour law,
- Intentional act of fabricating (producing) fake evidence in order to take disciplinary action against any worker,
- Any act done with an intention to give trouble or harass (worry) a worker,
- Act of intervention or cause to intervene in the activities relating to formation, operation and administrative functions of trade union,
- Act of continuing lock out which has been declared unlawful,
- Act of assaulting or cause to assault any worker,
- Any provocative act intended to create animosity or rift among workers,

Any of the following acts done by Trade unions shall be deemed to be unfair labour practice:

- Act of exerting pressure or threatening any worker to be or not to be a member of a union,
- Act of collecting donation or any other assistance forcibly,
- Act of picketing (hitting) or surrounding private residence or enterprise of employer other than the concerned workplace or act of causing to do so,
- Act of assaulting (beating) employer or his/her representatives or any worker or committing any unlawful activity for fulfillment of their demands or act of causing to do so,
- Act of damaging the property of employer intentionally.

The conduct is guide to ethical business commitment. It cannot cover every situation or circumstance, but it can be summarized in one simple idea: "do what is right". It shall be the duty of every worker to observe discipline and fulfill duties as prescribed under the Act, the rules made under this Act and the byelaws.

Misconducts (Bad behavior) and Punishment

The Act has classified misconducts of workers as follows:

(a) Misconducts that may require warning

Warning may be given to any worker involved in any of the following misconducts:

- Act of being absent in the work without approving the leave,
- Act of leaving the workplace without taking permission of the management,
- Act of reaching the workplace frequently late without taking permission of the management,
- Act of disobeying order given by employer or any employee above his/her level in relation to the work,
- Act of doing any other misconduct as specified in the bye laws.

(b) Misconduct that may require deduction of maximum one day remuneration

Maximum of one day remuneration may be deducted for the following misconducts by any worker:

- Act of refusing to accept any letter or notice issued by employer or officer having the authority to punish,
- Act of taking part in an illegal strike or forcing others to do so or adopting go slow tactic collectively,
- Act of causing loss to the enterprise by decreasing the production or service negligently or carelessly,
- Act of attempting to take benefits by submitting false documents,
- Act of not using safety equipment by worker responsible for using such equipment,
- Act of doing any other misconduct of similar nature specified in the by law.

(c) Misconduct that may withheld of annual salary increment for one year or promotion for one year

Annual salary increment for one year or promotion for one year may be withheld for the following misconducts by any worker:

- Act of taking and using or causing to use any property outside the enterprise without the permission of a person entrusted with such authority,
- Act of attempting to misappropriate the fund from the business of the employer,
- Act of damaging the property of the employer negligently or carelessly,
- Act of stopping the supply of food, water, telephone, electricity or obstructing the movement in and out of the workplace,
- Intentional act of misusing or causing damage or loss to the objects or provisions kept for the benefit or safety and health of the workers,
- Act of committing any other misconduct of similar nature prescribed in the by-law.

(d) Misconduct that may require dismissal of Worker

Worker may be dismissed for any of the following misconducts:

- Act of assaulting (hitting) or injuring an employer or any worker or customer or any person concerned with the workplace or act of keeping in captive (imprisoned) or causing unrest or damage in the premise of the enterprise with or without the use of any weapon,
- Act of taking or giving bribe,
- Act of stealing property of others in the workplace,
- Act of financial misappropriation in the enterprise,
- Intentional act of damaging the property of the employer under his/her control or which is being used by the employer,
- Act of being absent in the work continuously for more than 30 days without approving the leave,
- Act of divulging (disclosing) production related formula or any confidential information relating to special technology with an intention to cause loss or damage to the enterprise where he/she is employed,

- Act of working in collaboration with a competitive employer in the similar nature of business or carrying any competitive business on his own or providing confidential information about the enterprise where he is employed to any other competitive employer,
- If convicted by the court for any immoral or criminal act during the period of employment,
- Act of submitting forged or false educational certificates for the purpose of appointment,
- Act of taking drugs or liquor during working hours or come to the workplace in drunken state,
- Act of being punished for more than two times for misconducts mentioned in (a), (b) and (c) above within a period of three years,
- Act of committing any misconduct for which any prevailing law prescribes dismissal as punishment.

Process of Imposing Punishment

Before giving punishment to any worker for any misconduct, the Officer having the authority to punish shall give 7 days' notice for clarification by clearly stating the facts related to the misconduct and possible punishment if it is proved.

Power to give punishment for misconducts in case of enterprise shall lie with the Chief Executive of such enterprise. Any managerial level employee entrusted with the authority by the by-law to take final decision concerning the punishment for any misconduct shall be deemed to have power to investigate and give punishment also.

Where any worker is involved in any misconduct, the disciplinary action proceeding shall be initiated within two months from the date of notice of such misconduct. Decision shall be taken within three months from the date of initiation of such proceeding.

Nothing contained in this Chapter shall act as a constraint to give the lower punishment to the worker in place of higher one prescribed for any misconduct. If any enterprise has made a by-law prescribing lower punishment for the same misconduct for which the higher punishment has been prescribed under this Chapter, the same provision in the by-law, in relation to the workers of such enterprise, shall be applicable.

Provisions on Suspension

If any worker is detained (imprisoned) in the police custody pursuant to the law, such worker shall be automatically suspended for that period and shall not be entitled to receive remuneration during that period. However, if a worker is detained because of a complaint filed by the employer is proved innocent, he/she shall be entitled to receive the full remuneration for the period. The employment of such worker may be terminated by the employer if the period of suspension exceeds 90 days. When terminating the employment in such situation, an opportunity for clarification need not be given.

In situations other than above, worker may be suspended by the employer if it is found inappropriate to continue the employment or if there is a possibility of destroying the evidence relating to the misconduct if engaged in the work continuously, or if there is a possibility of

creating obstruction in investigation by the worker. The worker shall be entitled to receive half remuneration during the period of suspension. While suspending any worker as such, normally he/she shall not be suspended for more than 3 months. However, the period of suspension may be extended by one more month if the investigation is not completed. If a worker who is suspended is absolved from the allegation levied against him/her, he/she shall be entitled to receive all the remuneration along increment in salary if any, after deducting the amount of remuneration he/she has already received during the period of suspension.

15. TERMINATION OF EMPLOYMENT

Termination of employment means the time when the employee-employer relationship between the participant and the enterprise is terminated due to resignation, discharge, death, disability or retirement. The Act provides that employment of any worker shall not be terminated in any other condition except in accordance with the Act, rules under this Act or by-law. Valid and sufficient reasons shall be given when terminating the employment.

Termination of Time Based and Task Based Employment

Time based and task based employment of any worker shall end as follows:

(a) Time based employment of any worker shall come to an end when the time specified in the contract expires. However, in case of project based employment, the employment shall not end if the period of the project gets extended or the time for the completion of the work gets extended due to the nature of such work.
(b) Task based employment of any worker shall come to an end when the specified work is completed. However, in case of project based employment, the employment shall not end if the work in the project is increased or due to the nature of the work, the work is added.
(c) Casual employment shall come to an end at the will of the employer or worker if so desired.

Voluntary Termination of Employment

Any worker may terminate the employment by submitting a resignation in writing to the employer. The employer shall approve the resignation within 15 days and inform the worker accordingly. If the resignation is not approved by the employer within this period, the resignation shall be deemed to have been approved automatically from the day after such period expires. Despite of the submission of resignation by the employee, the resignation may be cancelled through mutual consent between the employer and the concerned worker. If the worker continues working in the same enterprise, even after the day his/her resignation is approved, such resignation shall be deemed to have been cancelled.

Termination of Employment on the Basis of Poor Work Performance

When evaluating the work performance of any worker pursuant to the provisions of the Act or the rules made under this Act or by-law, if the work performance of such worker is found unsatisfactory or poor for three or more than three times consecutively, the employment of such worker may be terminated by the employer. Before terminating the employment, the work performance evaluation must have been conducted as prescribed under the Act or the rules made under this Act or the by-law. The employer of any enterprise employing 10 or more workers

shall be required to give at least 7 days' time to the concerned worker for clarification before terminating the employment of any worker.

Termination of Employment on Medical Ground

If any worker becomes incapable of working as a result of physical or mental incapacitation or disablement or injury or probability of causing an adverse effect on the business of the employer because of long term medical treatment of the worker, the employer may terminate the employment of such worker on the basis of recommendation of a doctor. It further provides that, however, if there is a possibility, the employer shall engage the worker who is physically incapacitated or injured or disabled in any work suitable to the condition of his/her health.

The employer shall not terminate the employment of any worker during the period he/she is undergoing medical treatment in the hospital or within one year from the date of commencement of treatment at home because of an accident or occupational disease caused while performing the work. The employer shall give full pay during the period of such treatment. However, the employer shall not be required to pay such remuneration if the worker is entitled to receive the remuneration for the treatment period from the Social Security Fund.

The employer shall not have right to terminate the employment of any worker for a period of six months in case such worker is not able to attend the work in the enterprise on the ground of medical treatment. However, the employer may terminate the employment within the period of six months if there is a clear recommendation from the doctor about the inability of the worker to join the work again.

Notice Period

Any employer or worker, while terminating an employment contract in situations other than the termination of employment on the ground of misconducts, shall serve a written notice to each other as follows:

- At least before one day, in case of employment for a maximum period of four weeks,
- At least before seven days, in case of employment for a period of four weeks to one year,
- At least before 30 days, in case of employment for a period of more than one year.

If an employer terminates the employment without giving required notice, the equivalent amount of remuneration in lieu of notice shall be paid to the concerned worker. If a worker terminates the employment without giving required notice, the employer may deduct an amount equivalent to the remuneration for such notice period from the remuneration of the concerned worker which he/she is entitled to receive.

Retrenchment of Employees

Section 145 provides, if an enterprise faces financial problems in its operation, or the workers become excess because of merger of more than one enterprise or because of any other reason the enterprise needs to be closed down partially or completely, the employer may retrench workers.

Before retrenching the workers, the employer shall provide notice with information on the grounds for retrenchment, probable date for retrenchment and probable number of workers to be retrenched to the Office and authorized trade union of the enterprise or in absence of such authorized trade union, to any trade union which is active or labour relation committee of such enterprise at least 30 days before the date for retrenchment. After serving the notice, the employer shall consult the concerned trade union or the labour relation committee in relation to the matters concerning alternatives to the retrenchment of workers and the grounds and conditions for the selection of workers for retrenchment. If an agreement is reached, the employer may retrench the workers accordingly. If the trade union or the labour relation committee does not want to hold any consultation or fails to reach to an agreement in the consultation, the employer may retrench the workers accordingly after informing the Office about it.

The retrenchment of the workers shall normally be done in the following order:

- Foreign workers,
- Workers who have comparatively received more punishments for misconducts,
- Workers with poor work performance standard,
- Workers who are hired at the last from among the workers in the same category of work.

However, the workers who were appointed earlier may be retrenched first by stating the grounds for doing so without following the rule of retrenching the workers first who were hired last. The Act further provides that, unless otherwise agreed with the trade union, the office bearers of the Collective Bargaining Committee and the authorized trade union shall be retrenched last.

When retrenching workers, the employer shall pay a lump sum amount as compensation calculated at the rate of one month basic salary for each year of service to those workers who have completed at least one year of employment in such enterprise. If the service period is less than one year, the compensation shall be paid proportionately. The Act also provides that the worker shall not receive the compensation if he/she is entitled to receive unemployment benefit under the social security laws.

Where any enterprise is required to close down partially or completely in pursuance of the law or order of the Government of Nepal or Labour Court or any enterprise in the special economic zone is required to retrench its workers, the provisions of providing notice to the Office and authorized trade union and consultation with concerned trade union or labour relation committee shall not be applicable. The Act provides that the provision in this section relating to retrenchment shall not be applicable to any employer who employs ten or less workers.

Resumption of Operation

If any enterprise, after the workers are retrenched, resumes operation within two years or needs to hire more workers, the preference for employment shall be given to the workers retrenched pursuant to section 145. However, any other persons may be hired, if the workers who were retrenched fail to come in spite of the notice issued as prescribed. If the employer does not issue any notice or does not hire the workers who were retrenched, the concerned worker may submit

an application to the Labour Court within 35 days. Other provisions relating to this matter shall be as prescribed.

Compulsory Retirement

Any worker in regular employment shall retire compulsorily after completing the age of 58.However, if there is a need to give retirement to workers earlier than the age of 58 for special nature of work, a provision to that effect may be made in the by-law by acquiring approval from the Council as prescribed.

16. PROVISIONS REALTING TO LABOUR COURT

Establishment of Labour Court

Labour court is a court of law that deals with disagreements between employers and employees. The Government of Nepal shall establish required number of labour courts through notification in the Nepal Gazette. Jurisdiction and territory of the courts shall be as prescribed in the same notice published in the Nepal gazette. The Labour Court shall consist of one Chairperson and two members. Any sitting judge of the High Court or any person having the qualification of becoming a judge of the High Court shall be qualified to be chairperson or member of the Labour Court. Except when a sitting judge of the High Court is appointed as a member of the Court, the tenure of the chairperson and other members shall be four years. Employment conditions and benefits of the chairperson and members of the court shall be same as to that of judges of the High Court.

Section 152 provides decision making of the Labour Court in which all the three members shall use the powers of the court jointly. However, in the bench comprising of two members, in absence of the chairperson or any one of the members, can also initiate the court proceeding and decide a case. Decision based on the majority of members shall be the decision of the court.

If the opinions of the members differ in a bench comprising of two members, it shall be referred to the third member and the opinion supported by such member shall be the final decision of the court. If the opinions of the chairperson and other members differ, the opinion of the chairperson shall be the decision of the court.

Powers of the Labour Court

The Labour Court, apart from the powers specified in the Act or the rules made under this Act, may use the following powers in the course of deciding a case:

- Witness examination,
- Seek necessary explanation from respondent (defendant) treating it as written statement,
- The Labour Court, on the basis of application or nature of the case, may give an order to summon any party during the hearing even though such party has not been made neither defendant nor respondent in the case and if necessary make him a party to the case.
- Inspect places or workplace relating to the dispute,
- If an application filed by any party to a court proceeding to keep the case which is subjudice in the Labour Court in pending or give continuity till it is finally decided

and disposed if found reasonable, the Labour Court may, notwithstanding the state of the case, issue an interlocutory order against any of the parties to stop any act for a specified time or give continuity to any act with or without fixing a period,

- Confirm/invalidate/alter any directive or decision or order given by the Office or employer,
- The Labour Court, when carrying out a court proceeding and disposing a case, shall have powers as prescribed over the matters specified in the Act or the rules made under this Act and in other matters, it shall have the powers equivalent to that of any other District Court.

Proceeding against Contempt of Court

The Labour Court may initiate a legal proceeding for its contempt. If an act of contempt is established in the proceeding, such offender may be imposed a fine up to rupees ten thousand or six months imprisonment or both by the Labour Court. However, if the offender satisfies the court by seeking pardon, the Labour Court may forgive or absolve (excuse) punishment if already pronounced or reduce or put the punishment in pending on the prescribed conditions and accordingly give an order against the enforcement of the punishment.

Demand Bank Guarantee or Deposit

In the process of deciding a case filed under this Act, if there is a possibility of succeeding a claim on any amount by one party against the other party and it is probable that such party will not pay the amount, the Labour Court may in order to execute such decision, require the concerned party to deposit amount equivalent to the claim amount or require to give bank guarantee sufficient enough to cover such claim amount.

Order to Pay Interest

If an order is passed requiring a party to pay compensation or any other amount to the other party, such compensation or amount must be paid within 2 months from the date of notice of such order or decision. If the compensation or the amount is not paid within the period prescribed, an amount equivalent to 15% interest per annum charged on such compensation or amount from the date of decision of the case shall be required to be paid or deposited.

17. COMPLAINT, PUNISHMENT AND APPEAL

Where any person, employer, worker or officer acts in violation of the Act or the Rules made under this Act, the person affected by such act or the concerned trade union with a written consent of the affected person may file a complaint pursuant to section 163 (Department or Office) or 164 (Labour Court) to the competent authority having the power to decide within 6 months from the date of such act.

Power of the Department to Make Decision

The Department may act as follows after conducting necessary inquiry into the complaint on the following matters:

(a) Impose a fine of up to Rs. 200,000 and issue necessary order subject to the scope of this Act to any labour supplier supplying workers without acquiring any license to do so or any person who hires workers from such labour supplier and employs them in the work.
(b) Impose a fine of up to Rs. 200,000 on the basis of number of foreign workers employed and additional fine of Rs 5,000 per person per month in case such person continues to employ the foreign workers in spite of the punishment imposed earlier to any person who has employed foreign worker in any work without taking work permit.
(c) Impose a fine of up to Rs. 100,000 and issue an order for equal treatment to any person who discriminates workers at the time of hiring or during employment in violation of Chapter 2.
(d) Impose a fine of up to Rs. 500,000 at the rate of Rs. 10,000 per person and issue an order to give an appointment letter or execute an employment contract to any person who employs any worker without giving an appointment letter or executing any employment contract.
(e) Take a departmental action pursuant to the prevailing law to any inspector who causes loss or damage through any act done negligently or wrong fully pursuant to Chapter 15.
(f) Issue necessary order to any person who does any unfair labour practice or transfers any worker in an unjustified manner in violation of this Act or carries on activities relating to promotion in violation of the by-law of the enterprise.
(g) Issue necessary direction to the Labour Office in case it does not perform any task within 30 days from the date of ending of the period prescribed in the Act or the rules made under this Act for the accomplishment of such task.
(h) Carry out necessary work for the settlement of dispute if dispute relating to remuneration and benefits to be provided to workers arises between a labour supplier and a main employer.

Power of the Office to Make Decision

The office may act as follows after conducting necessary inquiry in relation to the application on the following matters:

(a) Make the employer pay the deducted amount and a damage equivalent to two times of such deducted amount to the concerned worker if any employer who pays any worker below the minimum wage or any remuneration or benefit is deducted in violation of the Act or the rules made under this Act.
(b) Impose a fine up to Rs. 20,000 to any employer or worker or person who obstructs the performance of duty by government employees or gives false description or statement or influences or attempts to influence in a wrong way.
(c) Impose a fine at the rate of Rs. 10,000 per apprentice or trainee and issue an order to employ such apprentice or trainee on regular employment and pay the remuneration and benefits accordingly to any employer who engages any person as an apprentice or trainee in violation of this Act.
(d) Issue an order to the employer to pay compensation and a damage equivalent to an amount which is two times more than such compensation to any employer who does not pay the amount of gratuity and provident fund or contribute the amount to the social security fund or pay medical expense or does not subscribe insurance for the purpose of compensation which workers are entitled to receive under the Act or the rules made under this Act.

(e) Issue a direction to the employer not to lay off workers to any employer laying off workers in violation of this Act or in a discriminatory manner.
(f) Issue necessary direction to the employer who terminates the employment or prohibits any worker from attending the work in violation of the Act or the rules made under this Act or the by-law.

Decision of the Labour Court

The Labour may act as follows on the following matters:

(a) Imprisonment up to two years or a fine up to Rs. 500,000 or both and may require such person to pay remuneration and other benefits including a damage equivalent to two times of such amount to any person engaging in forced labour. However, if any person engages someone in forced labour outside the territory of Nepal, the person involved in such act shall also be ordered to pay necessary expense to bring the affected person to Nepal.
(b) In case of death or disablement of any person as a result of non-compliance of provisions relating to Occupational Safety and Health under this Act or the rules made under this Act or death of any person as a result of occupational disease caused due to performance or nonperformance of any act or any part of the body is disabled or physical or mental state is adversely affected, the person involved in the act shall be punished pursuant to the provision in the prevailing law or in absence of such provision in the prevailing law, such person may be punished with imprisonment up to two years and make such person pay appropriate compensation to the affected person.
(c) If a corporate body commits any offence punishable under this Act, such body shall be punished with fines and if imprisonment is also prescribed for such offence, Chief Executive of such corporate body shall be imprisoned.

Execution of Decisions

Section 166 provides, if the decision or judgment given by the Labour Court pursuant to this Act becomes final or the limitation period for appeal ends, the concerned party shall enforce the decision against the other party. Any agreement reached in respect of an individual or a collective claim between any worker or trade union and employer or in presence of the Office or any other authority or officer or any decision of arbitrator shall be enforced in good faith by the concerned parties.

If the agreement or decision as above is not enforced, the affected party itself or through a trade union or an employers' association may file an application to the Office. On receipt of the application, the Office shall write to the concerned worker or employer for the enforcement of such agreement or decision or judgment. On receipt of such written direction, the concerned worker or employer shall enforce such agreement, decision or judgment within 15 days from the date of receipt of such direction.

The concerned person shall implement the decisions made by Department, Office or concerned officer pursuant to this Act or the Rules framed under this Act. The Department or the Office

shall punish the concerned person pursuant to this Act or the Rules who fails to implement the decisions made by the Department or Office.

Powers of Office in Relation to Enforcement of Agreement and Decisions

If the decision, judgment or agreement could not be enforced pursuant to section 166, the concerned party may file an application in the Office. On receipt of the application, the Office may enforce such decision, judgment or agreement against the concerned employer or worker by adopting any or all of the following means stated below:

- Write to the concerned authority or officer to freeze the immovable property of the concerned party or auction the property,
- Write to the concerned authority to freeze the bank account of the concerned party,
- Write to the concerned authority to suspend or withhold all the concessions or facilities provided to the concerned party as per the prevailing law,
- Write to the concerned authority to suspend the labour permit or license of the concerned party,
- Issue any other appropriate order.

Provision for Punishment for Non-execution of Decision, Compromise or Agreement

Section 168 provides, the Labour Court, for the purpose of execution of decision given by the Labour Court or Supreme Court on labour issues, shall issue a notice prescribing the time limit to the concerned party. The Labour Court may impose a fine up to Rs. 100,000 or maximum of one year of imprisonment to any employer or worker who refuses or delays or lingers the execution of the order of the Office issued for the enforcement of the order or decision given by the Labour Court or decision of an arbitrator or an agreement entered into between an employer and workers pursuant to this Act. However, if the order, decision, compromise, agreement or contract is executed within the period prescribed by the Labour Court, the Labour Court may annul (cancel) such punishment or give partial or full exemption in the enforcement of such punishment if already pronounced.

18. MISCELLANEOUS

Procedure Relating to Period and Notice

Any notice or period of limitation sent by the employer to any worker or to the employer by any worker shall be immediately acknowledged and proof of such acknowledgment shall be provided. If such notice or period of limitation could not be delivered, one copy of such notice or period of limitation certified by three witnesses shall be sent through courier or postal service at the given address and one copy shall be put at the workplace. Such notice or period of limitation shall be deemed to have been notified on time if the Office is informed about such certified notice or period of limitation. However, the application or notice given by the worker need not be put at the workplace.

If any worker refuses to accept such period of limitation or notice, it may be sent through fax or email or any other electronic means of communication. It shall be deemed to have been notified unless proved otherwise. Any notice on any matter required to be informed to all workers

collectively shall be deemed to have been received by the workers once it is put up on the notice board of the workplace and the trade union which is active in the enterprise is informed in writing accordingly.

Fixation of Basic Remuneration of Task Based Employment & Piece Rate Payment

Basic salary of any worker employed on task based employment contract shall be determined as prescribed. However, if the basic salary is not determined, the minimum wage fixed for the workers shall be regarded as basic salary.

In case of workers based on piece rate payment, rate of wage per piece shall be determined on the basis of the monthly minimum wage fixed pursuant to this Act.

Special Provisions Relating to Managers or Managerial Level Workers

Notwithstanding anything contained elsewhere in the Act, anything written in the Act shall not be a constraint in hiring a managerial level worker working in the capacity of Chief Executive on time based employment contract, fix employment conditions and benefits and terminate his/her service. Managers and managerial level workers are prohibited from submitting collective demands or taking part in collective bargaining or in strike on behalf of any trade union.

Remuneration and Other Benefits for Reinstated Worker

If a worker, who is terminated from the employment, is reinstated by the Office or Department or the order or decision of the Labour Court, such worker shall be entitled to receive remuneration and other benefits from the employer for the period starting from the date of termination to the date of reinstatement.

Nothing written in this Act shall act as a constraint to give a decision enabling the worker to receive reasonable amount as compensation in addition to the amount entitled above from the employer instead of reinstating such worker on the basis of the main issue of the dispute.

Special Powers of the Ministry

Except the issues subjudice in the Labour Court under this Act, nothing in this Act shall act as a constraint for the Ministry to give a decision acting on any application submitted to the Office or Department, in case the action in relation to the application has been pending for a long time making the situation tedious to the concerned party or if it becomes appropriate for the Ministry to act and decide because of complexity of the issue involved. The decision given on such matter shall be deemed to have been made by the body which is responsible at the first instance and the party dissatisfied with such decision may appeal in the Labour Court.

Labour Coordination Committee

Section 177 f the Act provides that there shall be a central level Labour Coordination Committee composing of members as prescribed under the chairmanship of the Director General of the Department. Rule 79 states that the Labour Coordination Committee shall be formed under the chairmanship of the Director General of the Department and the membership of Representative

of Trade Union Federation & Representatives of Employers Association. The function, duties and powers of the Committee shall be as follows:

- To discuss with the concerned party and provide necessary suggestions for the settlement of industrial dispute of any enterprise.

To make necessary arrangement and coordination with the concerned for the settlement of any dispute between the employer and the employee.

CHAPTER- 9

INSURANCE ACT 2049 (1992)

1. INTRODUCTION

History of insurance

In some sense, we can say that insurance appears simultaneously with the appearance of human society. We know about two types of economies in human societies: money economies (with markets, money, financial instruments and so on) and non-money or natural economies (without money, markets, financial instruments and so on). The second type is a more ancient form than the first. In such an economy and community, we can see insurance in the form of people helping each other. For example, if a house burns down, the members of the community help build a new one. Should the same thing happen to one's neighbour, the other neighbours must help otherwise, neighbours will not receive help in the future. This type of insurance has survived to the present day in some countries where modern money economy with its financial instruments is not widespread (for example countries in the territory of the former Soviet Union, in Nepal's villages also).

Turning to insurance in the modern sense (i.e., insurance in a modern money economy, in which insurance is part of the financial sphere), early methods of transferring or distributing risk were practiced by Chinese andBabylonian traders as long ago as the 3rd and 2ndmillennia BC, respectively. Chinese merchants travelling treacherous river rapids would redistribute their wares across many vessels to limit the loss due to any single vessel's capsizing. The Babylonians developed a system which was recorded in the famous Code of Hammurabi, c. 1750 BC, and practiced by early Mediterranean sailing merchants. If a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the shipment be stolen.

Achaemenian monarchs were the first to insure their people and made it official by registering the insuring process in governmental notary offices. The insurance tradition was performed each year in Norouz (beginning of the Iranian New Year); the heads of different ethnic groups as well as others willing to take part, presented gifts to the monarch. The most important gift was presented during a special ceremony. When a gift was worth more than 10,000 Derrik (Achaemenian gold coin) the issue was registered in a special office. This was advantageous to those who presented such special gifts. For others, the presents were fairly assessed by the confidants of the court. Then the assessment was registered in special offices.

The purpose of registering was that whenever the person who presented the gift registered by the court was in trouble, the monarch and the court would help him. Jahez, a historian and writer, writes in one of his books on ancient Iran: "[W]henever the owner of the present is in trouble or wants to construct a building, set up a feast, have his children married, etc. the one in charge of this in the court would check the registration. If the registered amount exceeded 10,000 Derrik, he or she would receive an amount of twice as much".

A thousand years later, the inhabitants of Rhodes invented the concept of the 'general average'. Merchants whose goods were being shipped together would pay a proportionally divided premium which would be used to reimburse any merchant whose goods were jettisoned during storm or sinkage.

The Greeks and Romans introduced the origins of health and life insurance c. 600 AD when they organized guilds called "benevolent societies" which cared for the families and paid funeral expenses of members upon death. Guilds in the Middle Ages served a similar purpose. The Talmud deals with several aspects of insuring goods. Before insurance was established in the late 17th century, "friendly societies" existed in England, in which people donated amounts of money to a general sum that could be used foremergencies.

Marine Insurance

One Mr. Lloyds was running a tea shop and restaurant near the sea during 1600's which saw heavy ship movements with expansion of trade with far east and far west in London where all the sailors used to meet and have tea/dinner. During their stay, the sailors used to discuss their experience during their journey from Far East and Far West. They will relate the stories where they saw other ships passing or crossing, any accident to ships on the sea on foreign shores, cyclones & typhoons at various places, threat of pirates at various places. Mr. Llyod used to keep a record by hearing their discussion about the fate of each ship where it was going. Whether it met with an accident, strike, or grounding or major repairs, lost in the sea due to cyclone or typhoon or caught by sea buccaneers and looted, the fate of any person who has died or suffering from disease etc.

Thus Mr. Lloyd was able to answer queries from inquisitive visitors who would like to know the fate of their relations, their cargo etc. and he used to advise them, depending on the speed of the ships and the ports it will call, the approximate time when the ship is expected to arrive or whether it is safe or lostetc.

This diary maintained by Mr. Lloyd became in course of time to be called Lloyds Register of Ships wherein the details of all the ships were entered and any transfer of ownership of any ship became to be recognised only when recorded in this register, which became a reference book for effecting insurance on the ships on the basis of the information contained in the Register.

Then the idea of collecting small amounts from each shippers and compensating the loss of others was developed and thus brokers used to collect at Lloyd's and on the basis of information provided on the safety and safe arrival of the ship, the condition of the ship, the character of the ship captain and the nature and quality of the cargo, decide on the premium to be charged. . Thus marine insurance was the first insurance of the modern times to start on the principle of collective sharing of loss incurred by a ship and in course of time various principles were evolved for the proper functioning. Thus Lloyds became famous for marine insurance and Lloyd's policy became the standard term, conditions and warranties for marineinsurance.

All the insurance brokers who gathered at Lloyds were collectively called Lloyds. But the business is done with individual insurers / brokers who have collected there and each insurer is to issue the policy and if he found the risk beyond his means, he will re-insurance part of the risk with other insurers. Insurance brokers were the middlemen who bring the person needing insurance to the insurers. On the basis of information received regarding the conditions on the voyage route of the ship, like nature of the cargo, war, riot, cyclones condition and age of the ship, the ship captain's quality and threat of other extra ordinary risks, the premium was used to

be fixed. The broker keeps contact with insurers who offer the various rates and brings the insured to the insurer who is most suitable to insure his particular goods or ship. Thus Lloyds was only a meeting place of insurers and brokers and they formed syndicates to cater to the needs of insurers and insureds and the individual insurer is responsible in respect of the risk heinsures.

There were two types of Marine Insurance viz. Cargo insurance relating to goods carried and Hull Insurance relating to the loss of the ship. Cargo Insurance is done by the cargo owners and the Hulls Insurance is done by the owner or lessee or charterer of the ship.

After more than three hundred years, fire insurance was developed as part of marine insurance only. But after 1930's marine / non-marine general insurance was segregated with different rules.

Characteristics of Insurance

Commercially insurable risks typically share seven common characteristics.

(1) A large number of homogeneous exposure units.

The vast majority of insurance policies are provided for individual members of very large classes. Automobile insurance, for example, covered about 175 million automobiles in the United States in 2004.[2] The existence of a large number of homogeneous exposure units allows insurers to benefit from the so- called ‒law of large numbers,‖which in effect states that as the number of exposure units increases, the actual results are increasingly likely to become close to expected results. There are exceptions to this criterion. Lloyd's ofLondon is famous for insuring the life or health of actors, actresses and sports figures. Satellite Launch insurance covers events that are infrequent. Large commercial property policies may insure exceptional properties for which there are no homogeneous exposure units. Despite failing on this criterion, many exposures like these are generally considered to b einsurable.

(2) Definite Loss

The event that gives rise to the loss that is subject to insurance should, at least in principle, take place at a known time, in a known place, and from a known cause. The classic example is death of an insured on a life insurance policy. Fire, automobile accidents, and worker injuries may all easily meet this criterion. Other types of losses may only be definite in theory. Occupational disease, for instance, may involve prolonged exposure to injurious conditions where no specific time, place or cause is identifiable. Ideally, the time, place and cause of a loss should be clear enough that a reasonable person, with sufficient information, could objectively verify all three elements.

(3) Accidental Loss.

The event that constitutes the trigger of a claim should be fortuitous, or at least outside the control of the beneficiary of the insurance. The loss should be pure in the sense that it results from an event for which there is only the opportunity for cost. Events that contain speculative elements, such as ordinary business risks, are generally not considered insurable.

(4) Large Loss

The size of the loss must be meaningful from the perspective of the insured. Insurance premiums need to cover both the expected cost of losses, plus the cost of issuing and administering the policy, adjusting losses, and supplying the capital needed to reasonably assure that the insurer will be able to pay claims. For small losses these latter costs may be several times the size of the expected cost of losses. There is little point in paying such costs unless the protection offered has real value to a buyer.

(5) Affordable Premium

If the likelihood of an insured event is so high, or the cost of the event so large, that the resulting premium is large relative to the amount of protection offered, it is not likely that anyone will buy insurance, even if on offer. Further, as the accounting profession formally recognizes in financial accounting standards (See FAS 113 for example), the premium cannot be so large that there is not a reasonable chance of a significant loss to the insurer. If there is no such chance of loss, the transaction may have the form of insurance, but not the substance.

(6) Calculable Loss

There are two elements that must be at least estimable, if not formally calculable: the probability of loss, and the attendant cost. Probability of loss is generally an empirical exercise, while cost has more to do with the ability of a reasonable person in possession of a copy of the insurance policy and a proof of loss associated with a claim presented under that policy to make a reasonably definite and objective evaluation of the amount of the loss recoverable as a result of the claim.

(7) Limited risk of catastrophically large losses.

The essential risk is often aggregation. If the same event can cause losses to numerous policyholders of the same insurer, the ability of that insurer to issue policies becomes constrained, not by factors surrounding the individual characteristics of a given policyholder, but by the factors surrounding the sum of all policyholders so exposed. Typically, insurers prefer to limit their exposure to a loss from a single event to some small portion of their capital base, on the order of 5 percent. Where the loss can be aggregated, oran individual policy could produce exceptionally large claims, the capital constraint will restrict an insurer's appetite for additional policyholders. The classic example is earthquake insurance, where the ability of an underwriter to issue a new policy depends on the number and size of the policies that it has already underwritten. Wind insurance in hurricane zones, particularly along coast lines, is another example of this phenomenon. In extreme cases,the aggregation can affect the entire industry, since the combined capital of insurers and reinsurers can be small compared to the needs of potential policyholders in areas exposed to aggregation risk. In commercial fire insurance it is possible to find single properties whose total exposed value is well in excess of any individual insurer's capital constraint. Such properties are generally shared among several insurers, or are insured by a single insurer who syndicates the risk into the reinsurance market.

Indemnification

The technical definition of "indemnity" means to make whole again. There are two types of insurance contracts; (a) an "indemnity" policy and (b) a "pay on behalf or on behalf of" policy. The difference is significant on paper, but rarely material in practice.

An "indemnity" policy will not pay claims until the insured has paid out of pocket to some third party; i.e. a visitor to your home slips on a floor that you left wet and sues you for $10,000 and wins. Under an "indemnity" policy the homeowner would have to come up with the $10,000 to pay for the visitors fall and then would be "indemnified" by the insurance carrier for the out of pocket costs (the $10,000).

Under the same situation, a "pay on behalf" policy, the insurance carrier would pay the claim and the insured (the homeowner) would not be out of pocket anything. Most modern liability insurance is written on the basis of "pay on behalf" language.

An entity seeking to transfer risk (an individual, corporation, or association of any type, etc.) becomes the 'insured' party once risk is assumed by an 'insurer', the insuring party, by means of a contract, called an insurance 'policy'. Generally, an insurance contract includes, at a minimum, the following elements: the parties (the insurer, the insured, the beneficiaries), the premium, the period of coverage, the particular loss event covered, the amount of coverage (i.e., the amount to be paid to the insured or beneficiary in the event of a loss), and exclusions (events not covered). An insured is thus said to be "indemnified" against the loss events covered in the policy.

When insured parties experience a loss for a specified peril, the coverage entitles the policyholder to make a 'claim' against the insurer for the covered amount of loss as specified by the policy. The fee paid by the insured to the insurer for assuming the risk is called the 'premium'. Insurance premiums from many insureds are used to fund accounts reserved for later payment of claims in theory for a relatively few claimants and for overhead costs. So long as an insurer maintains adequate funds set aside for anticipated losses (i.e., reserves), the remaining margin is an insurer's profit.

Contract of Indemnity

It has been noted *supra* that contracts of insurance are contracts of indemnity, because a typical contract of insursnce involves an obligation on the part of the insurer to pay a sum of money to the assured upon the happening of an uncertain event. But there are some contracts of insursnce which are not, however, contracts of indemnity.Thus marine insurance and fire insursnce are contracts of indemnity, but life insursnce and personal accident insurance are not contract of indemnity. Where the insursnce is a contract of indemnity, the happening of the event does not by itself entitle the insured to the payment of the sum insured. The event must result in pecuniary loss to the insured alone, when alone, he becomes entitled to be *indemnified*, subject to the terms of his contract, (policy of fire insurance). Further the insured can recover no mor ethan the sum insured, for tht sum fixes the maximum liability of the insurer, and even that amount cannot be recovered unless it represents the actual loss sustained by the insured. In other words, the contract being one of indemnity, the insured can only recover the amount of his loss and no

more. Contracts of life insurnce are not contracts of indemnity, but in a way constitute a form of investment. In these cases there is no necessity to prove a pecuniary loss, and the moment the event happens whether it be the attaining of particular age or death whichever is earlier, as in the case of an *endowment policy*, or death, as in the case of *whole life policy* - the sum insured becomes payable.

Types of Insurance

Any risk that can be quantified can potentially be insured. Specific kinds of risk that may give rise to claims are known as "perils". An insurance policy will set out in detail which perils are covered by the policy and which are not.

Below is a (non-exhaustive) list of the many different types of insurance that exist. A single policy may cover risks in one or more of the categories set forth below. For example, auto insurance would typically cover both property risk (covering the risk of theft or damage to the car) and liability risk (covering legal claims from causing an accident). A homeowner's insurance policy in the U.S. typically includes property insurance covering damage to the home and the owner's belongings, liability insurance covering certain legal claims against the owner, and even a small amount of health insurance for medical expenses of guests who are injured on the owner's property.

- **Automobile insurance**, known in the UK as *motor insurance*, is probably the most common form of insurance and may cover both legal liability claims against the driver and loss of or damage to the insured's vehicle itself. Throughout the United States auto insurance policy is required to legally operate a motor vehicle on public roads. In some jurisdictions, bodily injury compensation for automobile accident victims has been changed to a no-fault system, which reduces or eliminates the ability to sue for compensation but provides automatic eligibility for benefits. Credit card companies insure against damage on rented cars.
- **Aviation insurance** insures against hull, spares, deductible, hull war and liability risks.
- **Boiler insurance**(also known as boiler and machinery insurance or equipment breakdown insurance) insures against accidental physical damage to equipment or machinery.
- **Builder's risk insurance**insures against the risk of physical loss or damage to property during construction. Builder's risk insurance is typically written on an "all risk" basis covering damage due to any cause (including the negligence of the insured) not otherwise expressly excluded.
- **Business insurance** can be any kind of insurance that protects businesses against risks. Some principal subtypes of business insurance are (a) the various kinds of *professional liability insurance*, also called *professional indemnity insurance*, which are discussed below under that name; and (b) the business owners policy (BOP), which bundles into one policy many of the kinds of coverage that a business owner needs, in a way analogous to how homeowners insurance bundles the coverages that a home owner needs.
- **Casualty insurance** insures against accidents, not necessarily tied to any specific property.
- **Credit insurance** repays some or all of a loan back when certain things happen to the borrower such as unemployment,disability, or death. Mortgage insurance (which see below)

is a form of credit insurance, although the name *credit insurance* more often is used to refer to policies that cover other kinds of debt.

- **Crime insurance** insures the policyholder against losses arising from the criminal acts of third parties. For example, a company can obtain crime insurance to cover losses arising from theft or embezzlement.
- **Crop insurance:** "Farmers use crop insurance to reduce or manage various risks associated with growing crops. Such risks include crop loss or damage caused by weather, hail, drought, frost damage, insects, or disease, for instance.
- **Defense Base Act Workers' compensation** or **DBA Insurance** insurance provides coverage for civilian workers hired by the government to perform contracts outside the US and Canada. DBA is required for all US citizens, US residents, US Green Card holders, and all employees or subcontractors hired on overseas government contracts. Depending on the country, Foreign Nationals must also be covered under DBA. This coverage typically includes expenses related to medical treatment and loss of wages, as well as disability and death benefits.
- **Directors and officers liability insurance** protects an organization (usually a corporation) from costs associated with litigation resulting from mistakes incurred by directors and officers for which they are liable. In the industry, it is usually called "D & O" for short.
- **Disability insurance** policies provide financial support in the event the policyholder is unable to work because of disabling illness or injury. It provides monthly support to help pay such obligations as mortgages and creditcards. Total permanent disability insurance insurance provides benefits when a person is permanently disabled and can no longer work in their profession, often taken as an adjunct to life insurance.
- **Errors and omissions insurance**: See "Professional liability insurance" under "Liability insurance".
- **Expatriate insurance** provides individuals and organizations operating outside of their home country with protection for automobiles, property, health, liability and business pursuits.
- **Financial loss insurance** protects individuals and companies against various financial risks. For example, a business might purchase cover to protect it from loss of sales if a fire in a factory prevented it from carrying out its business for a time. Insurance might also cover the failure of a creditor to pay money it owes to the insured. This type of insurance is frequently referred to as "business interruption insurance." Fidelity bonds and surety bonds are included in this category, although these products provide a benefit to a third party (the "obligee") in the event the insured party (usually referred to as the "obligor") fails to perform its obligations under a contract with the obligee.
- **Fire insurance**: See "Property insurance".
- **Hazard insurance:** See "Property insurance".
- **Health insurance** policies will often cover the cost of private medical treatments if the National Health Service in the UK (NHS) or other publicly-funded health programs do not pay for them. It will often result in quicker health care where better facilities are available.

- **Home insurance** or homeowners insurance: See "Property insurance".
- **Liability insurance** is a very broad superset that covers legal claims against the insured. Many types of insurance include an aspect of liability coverage. For example, a homeowner's insurance policy will normally include liability coverage which protects the insured in the event of a claim brought by someone who slips and falls on the property; automobile insurance also includes an aspect of liability insurance that indemnifies against the harm that a crashing car can cause to others' lives, health, or property. The protection offered by a liability insurance policy is twofold: a legal defense in the event of a lawsuit commenced against the policyholder and indemnification (payment on behalf of the insured) with respect to a settlement or court verdict. Liability policies typically cover only the negligence of the insured, and will not apply to results of willful or intentional acts by the insured.
- **Environmental liability insurance** protects the insured from bodily injury, property damage and cleanup costs as a result of the dispersal, release or escape of pollutants.
- **Professional liability insurance,** also called *professional indemnity insurance*, protects professional practitioners such as architects, lawyers, doctors, and accountants against potential negligence claims made by their patients/clients. Professional liability insurance may take on different names depending on the profession. For example, professional liability insurance in reference to the medical profession may be called *malpractice insurance.* Notaries public may take out *errors and omissions insurance (E&O).* Other potential E&O policyholders include, for example, real estate brokers, home inspectors, appraisers, and website developers. In UK for professional to practice as auditors and financial service providers should take professional liability insurance; otherwise they will be liable for disciplinary proceedings.
- **Life insurance** provides a monetary benefit to a decedent's family or other designated beneficiary, and may specifically provide for income to an insured person's family, burial, funeral and other final expenses. Life insurance policies often allow the option of having the proceeds paid to the beneficiary either in a lump sum cash payment or an annuity.
- **Annuities provide** a stream of payments and are generally classified as insurance because they are issued by insurance companies and regulated as insurance and require the same kinds of actuarial and investment management expertise that life insurance requires. Annuities and pensions that pay a benefit for life are sometimes regarded as insurance against the possibility that a retiree will outlive his or her financial resources. In that sense, they are the complement of life insurance and, from an underwriting perspective, are the mirror image of life insurance.
- **Locked funds insurance** is a little-known hybrid insurance policy jointly issued by governments and banks. It is used to protect public funds from tamper by unauthorized parties. In special cases, a government may authorize its use in protecting semi-private funds which are liable to tamper. The terms of this type of insurance are usually very strict. Therefore it is used only in extreme cases where maximum security of funds is required.
- **Marine insurance** and marine cargo insurance cover the loss or damage of ships at sea or on inland waterways, and of the cargo that may be on them. When the owner of the cargo

and the carrier are separate corporations, marine cargo insurance typically compensates the owner of cargo for losses sustained from fire, shipwreck, etc., but excludes losses that can be recovered from the carrier or the carrier's insurance. Many marine insurance underwriters will include "time element" coverage in such policies, which extends the indemnity to cover loss of profit and other business expenses attributable to the delay caused by a covered loss.

- **Mortgage insurance** insures the lender against default by the borrower.
- **National Insurance** is the UK's version of social insurance. **Social insurance** can be many things to many people in many countries. But a summary of its essence is that it is a collection of insurance coverages (including components of life insurance, disability income insurance, unemployment insurance, health insurance, and others), plus retirement savings, that mandates participation by all citizens. By forcing everyone in society to be a policyholder and pay premiums, it ensures that everyone can become a claimant when or if he/she needs to. Along the way this inevitably becomes related to other concepts such as the justice system and the welfare state. This is a large, complicated topic that engenders tremendous debate, (which see below).
- **No-fault insurance** is a type of insurance policy (typically automobile insurance) where insureds are indemnified by their own insurer regardless of fault in the incident.
- **Nuclear incident insurance** covers damages resulting from an incident involving radioactive materials and is generally arranged at the national level. (For the United States, see the Price-Anderson Nuclear Industries IndemnityAct.)
- **Pet insurance** insures pets against accidents and illnesses - some companies cover routine/wellness care and burial, as well.
- **Political risk insurance** can be taken out by businesses with operations in countries in which there is a risk that revolution or other political conditions will result in a loss.
- **Pollution Insurance:** A first-party coverage for contamination of insured property either by external or on-site sources. Coverage for liability to third parties arising from contamination of air, water, or land due to the sudden and accidental release of hazardous materials from the insured site. The policy usually covers the costs of cleanup and may include coverage for releases from underground storage tanks. Intentional acts are specifically excluded
- **Prize indemnity insurance** protects the insured from giving away a large prize at a specific event. Examples would include offering prizes to contestants who can make a half-court shot at a basketball game, or a hole-in-one at a golf tournament.
- **Property insurance** provides protection against risks to property, such as fire, theft or weather damage. This includes specialized forms of insurance such as fire insurance, flood insurance, earthquake insurance, home insurance, inland marine insurance or boiler insurance.
- **Protected Self-Insurance** is an alternative risk financing mechanism in which an organisation retains the mathematically calculated cost of risk within the organisation and transfers the catastrophic risk with specific and aggregate limits to an Insurer so the maximum total cost of the program is known. A properly designed and underwritten Protected Self-Insurance Program reduces and stabilizes the cost of insurance and provides valuable risk management information.

- **Purchase insurance**is aimed at providing protection on the products people purchase. Purchase insurance can cover individual purchase protection, warranties, guarantees, care plans and even mobile phone insurance. Such insurance is normally very limited in the scope of problems that are covered by the policy.
- **Retrospectively Rated Insurance** is a method of establishing a premium on large commercial accounts. The final premium is based on the insured's actual loss experience during the policy term, sometimes subject to a minimum and maximum premium, with the final premium determined by a formula. Under this plan, the current year's premium is based partially (or wholly) on the current year's losses, although the premium adjustments may take months or years beyond the current year's expiration date. The rating formula is guaranteed in the insurance contract. Formula: retrospective premium = converted loss + basic premium × tax multiplier. Numerous variations of this formula have been developed and are in use.
- **Formal Self Insurance** is the deliberate decision to pay for otherwise insurable losses out of one's own money. This can be done on a formal basis by establishing a separate fund into which funds are deposited on a periodic basis, or by simply forgoing the purchase of available insurance and paying out-of-pocket. Self insurance is usually used to pay for high-frequency, low-severity losses. Such losses, if covered by conventional insurance, mean having to pay a premium that includes loadings for the company's general expenses, cost of putting the policy on the books, acquisition expenses, premium taxes, and contingencies. While this is true for all insurance, for small, frequent losses the transaction costs may exceed the benefit of volatility reduction that insurance otherwise affords.
- **Stop-loss insurance** provides protection against catastrophic or unpredictable losses. It is purchased by organisations who do not want to assume 100% of the liability for losses arising from the plans. Under a stop-loss policy, the insurance company becomes liable for losses that exceed certain limits called deductibles.
- **Surety Bond insurance** is a three party insurance guaranteeing the performance of the principal.
- **Terrorism insurance** provides protection against any loss or damage caused by terrorist activities.
- **Title insurance** provides a guarantee that title to real property is vested in the purchaser and/or mortgagee, free and clear of liens or encumbrances. It is usually issued in conjunction with a search of the public records performed at the time of a real estate transaction.
- **Travel insurance** is an insurance cover taken by those who travel abroad, which covers certain losses such as medical expenses, lost of personal belongings, travel delay, personal liabilities,etc.
- **Volcano insurance** is an insurance that covers volcano damage in Hawaii.
- **Workers' compensation** insurance replaces all or part of a worker's wages lost and accompanying medical expense incurred because of a job-related injury.
- **Keyman Insurance**: The development and continuation of certain business depends on the special efforts and knowledge of particular person/s in the business and the loss of those persons will affect the business very much. So the business takes out a keyman insurance in

respect of those persons so that in case they are disabled or die due to accidents or health problems, the company will receive the benefit of the proceeds of the policy.

Life Insurance and Saving

Certain life insurance contracts accumulate cash values, which may be taken by the insured if the policy is surrendered or which may be borrowed against. Some policies, such as annuities and endowment policies, are financial instruments to accumulate or liquidate wealth when it is needed. See life insurance.

In many countries, such as the U.S. and the UK, the tax law provides that the interest on this cash value is not taxable under certain circumstances. This leads to widespread use of life insurance as a tax-efficient method of saving as well as protection in the event of early death.

In U.S., the tax on interest income on life insurance policies and annuities is generally deferred. However, in some cases the benefit derived from tax deferral may be offset by a low return. This depends upon the insuring company, the type of policy and other variables (mortality, market return, etc.). Moreover, other income tax saving vehicles (e.g., IRAs, 401(k) plans, Roth IRAs) may be better alternatives for value accumulation. A combination of low-cost term life insurance and a higher-return tax-efficient retirement account may achieve better investment return.

Types of Insurance Companies

Insurance companies may be classified as

- *Life* insurance companies, which sell life insurance, annuities and pensions products.
- *Non-life* or *general* insurance companies, which sell other types of insurance.
- *Re-insurance companies*

General insurance companies can be further divided into these subcategories.

- Standard Lines
- Excess Lines

In most countries, life and non-life insurers are subject to different regulatory regimes and different tax and accounting rules. The main reason for the distinction between the two types of company is that life, annuity, and pension business is very long-term in nature coverage for life assurance or a pension can cover risks over many decades. By contrast, non-life insurance cover usually covers a shorter period, such as one year.

In the United States, standard line insurance companies are your "main stream" insurers. These are the companies that typically insure your auto, home or business. They use pattern or "cookie-cutter" policies without variation from one person to the next. They usually have lower premiums than excess lines and can sell directly to individuals. They are regulated by state laws that can restrict the amount they can charge for insurance policies.

Excess line insurance companies (aka Excess and Surplus) typically insure risks not covered by the standard lines market. They are broadly referred as being all insurance placed with non-

admitted insurers. Non-admitted insurers are not licensed in the states where the risks are located. These companies have more flexibility and can react faster than standard insurance companies because they don't have the same regulations as standard insurance companies. State laws generally require insurance placed with surplus line agents and brokers to be not available through standard licensed insurers.

Insurance companies are generally classified as either *mutual* or *stock* companies. This is more of a traditional distinction as true mutual companies are becoming rare. Mutual companies are owned by the policyholders, while stockholders (who may or may not own policies) own stock insurance companies. Other possible forms for an insurance company include reciprocals, in which policyholders 'reciprocate' in sharing risks, and Lloyds organizations.

Insurance companies are rated by various agencies such as A. M. Best. The ratings include the company's financial strength, which measures its ability to pay claims. It also rates financial instruments issued by the insurance company, such as bonds, notes, and securitization products.

Reinsurance **companies** are insurance companies that sell policies to other insurance companies, allowing them to reduce their risks and protect themselves from very large losses. The reinsurance market is dominated by a few very large companies, with huge reserves. A reinsurer may also be a direct writer of insurance risks as well.

Captive insurance **companies** may be defined as limited-purpose insurance companies established with the specific objective of financing risks emanating from their parent group or groups. This definition can sometimes be extended to include some of the risks of the parent company's customers. In short, it is an in-house self-insurance vehicle. Captives may take the form of a "pure" entity (which is a 100 percent subsidiary of the self-insured parent company); of a "mutual" captive (which insures the collective risks of members of an industry); and of an "association" captive (which self-insures individual risks of the members of a professional, commercial or industrial association). Captives represent commercial, economic and tax advantages to their sponsors because of the reductions in costs they help create and for the ease of insurance risk management and the flexibility for cash flows they generate. Additionally, they may provide coverage of risks which is neither available nor offered in the traditional insurance market at reasonable prices.

The types of risk that a captive can underwrite for their parents include property damage, public and products liability, professional indemnity, employee benefits, employer's liability, motor and medical aid expenses. The captive's exposure to such risks may be limited by the use of reinsurance.

Captives are becoming an increasingly important component of the risk management and risk financing strategy of their parent. This can be understood against the following background:

- Heavy and increasing premium costs in almost every line of coverage;
- Difficulties in insuring certain types of fortuitous risk;
- Differential coverage standards in various parts of the world;

- Rating structures which reflect market trends rather than individual loss experience;
- Insufficient credit for deductibles and/or loss control efforts.

There are also companies known as 'insurance consultants'. Like a mortgage broker, these companies are paid a fee by the customer to shop around for the best insurance policy amongst many companies.

Similar to an insurance consultant, an 'insurance broker' also shops around for the best insurance policy amongst many companies. However, with insurance brokers, the fee is usually paid in the form of commission from the insurer that is selected rather than directly from the client.

Neither insurance consultants nor insurance brokers are insurance companies and no risks are transferred to them in insurance transactions. Third party administrators are companies that perform underwriting and sometimes claims handling services for insurance companies. These companies often have special expertise that the insurance companies do not have.

2. LEGAL PRINCIPLES OF INSURANCE

LEGALPRICIPLES OF INSURANCE

(a) Insurance - A Contract of Good Faith

In non-marine insurance the assured is generally required to fill up and sign a printed form a proposal in which particulars of the proposed insurance are stated. The form is prepared by the insurers and it contains a series of question regarding (a) the personal particulars; (b) particulars of the risk to be assured; (c) circumstances affecting the risk; (d) previous experience of the assured; (e) previous assurance record of the assured.

The answers furnished by the assured regarding these particulars from the basis on which the insurers accept or reject the proposal, and the assured in giving these answers will be acting pursuant to his duty to make a full disclosure. It is therefore necessary that the answers given should be substantially accurate though not absolutely true in all details. Very often a proposal form contains a declaration signed by the assured to the effect that the statements contained therein are true, and that they form the basis of the contract between the parties. In such a case the truth of the answer is made a condition precedent to the validity of the policy, which will be rendered voidable by any inaccuracy, even if it be in respect of an immaterial detail.

(b) Cover Notes and Agreements to Insure

In order that there may be a binding contract of insurance there must be completed agreement as to all its terms. In the case of a printed proposal form, which is generally supplied by insurers in the case of non-marine insurance, the contracts will be completed only upon the acceptance of the proposal by the insurers. Until acceptance they are not bound, and they are at liberty to introduce fresh terms constituting a counter offer, which the assured must accept before there can be binding contract. Pending the acceptance of the proposal by the insurer in a formal manner by the issue of a policy, the insurers may agree to grant the issued cover, whereby he is protected until the fate of the proposal is decided. It may be oral or may be embodied in a formal document, called a cover note which is a temporary and limited agreement. After the policy is

issued the cover note is superseded. During the currency of the cover note the parties are governed only by its terms, and not by the terms of the policy, unless the parties agree that they shall be bound even in respect of the cover note by the terms of the policy.

A contact of non-marine insurance is generally expressed in a document called a *policy*. The word 'policy' is applied to the formal document which is used in the course of insurance business to express the contract of the insurers. Generally the policies of non-marine insurance adopt the same form, though they may vary in some details. The policy though in form a unilateral undertaking by the insurers to pay the sum insured, upon the happening of some specified event, it is the exclusive record of the contract *inter partes* containing the terms and conditions on which the contract is entered into, and its terms are therefore equally binding upon the assured.

In an Indian Case :

The plaintiff insured certain goods with the defendant company. The cover note was issued on 18th June, 1951 and it stated that the goods were insured from 15th. The cover note was for the sum mentioned therein. The goods were destroyed by fire on 16th June 1951, though neither party was aware of it on June 18. In a suit by plaintiffs claiming the amount under the policy it was held:(a) that the parties intended and agreed that the risk should be retrospective from June 15, and that the defendant company was liable; and (b) as the intention was that risk should attach in the past, and they were ignorant of the destruction of the goods, there was no question of mistake under section 20 of the Indian Contract Act.

(c) Premium

The premium is the consideration for the insurance, and its amount is measured by the estimate of risk formed by the insurers upon an average of their previous experience, or similar risks, together with an allowance for office expenses and other charges and profit. There cannot be a contract unless and until the premium is agreed. In the event of the assured's death , any premium due at the date of his death may be paid by his legal representative except in case where the policy contemplates a payment only by his legal representative except in case where the policy contemplates a payment only by the assured . The assured becomes liable to pay the premium as soon as the contract is concluded. If there is a stipulation that the liability will attach itself under contract only if the premium is paid, that will be a condition precedent to the policy taking effect

If the policy is voidable on account of a fraudulent misrepresentation of the assured, the insurer can have a policy set aside without being liable to return the premia. But the assured is entitled to claim a return of the premium when there is a failure of consideration arising from the contract. viz. (a) when there is no binding contract of insurance at all e.g. when the contract is void or voidable, or (b) where there is not anything at risk, e.g. the person whose lifeis insured dying before commencement of the insurance when the policy contains a term that if the policy is void the premium shall be forfeited, the premiums are not recoverable.

But once the risk is attached, the insurer cannot be compelled to return the premium. If the insurance policy is illegal, whether because there is no insurable interest or from any other cause, the premiums cannot be recovered back by the insured.

But when the insurer and the assured are not in paridelicto‘and the assured is the innocent party, he can recover the premiums paid.

A policy which lapses owing to non-payment of the premium may be revived at any time by mutual consent of the parties, but on revival there is a fresh contract and it does not cover a loss happening before such revival.

(d) Subrogation

The rule of subrogation being a corollary to the principle of indemnity, applies to allcontracts of non-marine insurance which are contracts of indemnity (*supra*).

Subrogation is the right of insurer to enforce for their own benefit all the rights and remedies which are assured possesses against third parties in respect of the subject matter. If those third parties are also insured, the ultimate liability for the loss may fall upon the insurers. The right of subrogation does not arise until the insurer have admitted their liability to the assured and have paid him the amount of the loss. It is available whether the third party is liable to the assured on the basis of contract, or on the basis of a tort. It is available whether the loss is total or partial. As noticed *supra* the right of subrogation cannot be enforced unless the insurer obtains from the assured a formal assignment of his right of action against the third party. It may be noted that the doctrine of subrogation does not apply to the contract of life assurance and personal accident assurance, which are nor contracts of indemnity.

(e) Double Insurance

Sometimes the assured may effect insurance with two or more insurers in respect of the same risk, when it is called *double insurance*. If the two policies together cause an over-insurance the excess cannot be recovered, but the assured may sue on whichever policy he desires, and recover the whole sum to which he is entitled by way of indemnity. In practice every proposal for non-marine insurance contains a question requiring information regarding the existing insurance. The effect of double insurance, in some cases where the contract of in one of indemnity, (i.e. other than life and personal accident) is that the insurer, in the absence of a condition to the contrary in any of the policies. But the insurer who is so made liable can claim contribution from hisco-insurers.

(a) Contribution Clause

This is a provision restricting the liability of the insurer in case of double insurance, to a ratable proportion of the loss. In such a case, the assured cannot recover the payment in full under any one policy, because each of the policies is liable only for its ratable proportion. In practice many policies of non-marine insurance contain this clause.

(b) Average Clause

This is a provision which provides that if at the time of the loss the sum insured is less than the value of the property, the assured is to be considered as his own insurer for the difference, and should bear a ratable proportion of the loss accordingly. Non-marine policies are not, in the absence of a stipulation to the contrary, subject to the rule of average clause, and an assured is not therefore prejudiced by the reason of under insurance, and can recover the full amount of the loss, whether total, or partial, up to the sum assured policies insuring mercantile property, and particularly fire policies, generally contain this clause.

(F) Suicide

The event which under an ordinary policy of life assurance gives the right to payment, in the death of the assured during the currency of the policy, whatever may be the cause of death, whether it is natural, or accidental, or even by a criminal act on himself, or of a third person. The insurers therefore provide for an exception to their liability in the case of suicide, or as it is said if the assured die by his own hand. In such a case, the insurer can avoid the policy, whether the assured was sane at the time of committing suicide, or even if insane, he knew what he was doing, and was capable of appreciating the consequences. Nothing, however, prevents an insurer by means of suitable terms in the policy from exonerating himself from liability in all cases of self destruction, i.e. when the assured was totally insane at the time.

When the policy is silent in regard to the insurer‘s liability in case of suicide of the assured, the insurer would be liable only if the assured commits suicide while insane, but not otherwise.

The onus of providing suicide is upon the insurer, and where the cause of death is not known, the presumption is against suicide, and the policy cannot be avoided.

If a person causes the death of the assured under circumstances which would amount to a crime, e.g. by murdering him, the murderer is not entitled to recover the insurance money on grounds of public policy.

(g) Circumstances affecting Risk

Though every one is bound to die, the date when death takes place in the case of a given individual is an uncertain event. But as the contract of life assurance is based upon the average duration of human life, it becomes obvious that facts which tend to suggest that the life assured is likely to fall short of the average duration, are material facts, and the details which are required in the proposal form should therefore be answered fully and faithfully. The following are circumstances about which the insurers require information for accepting or rejecting the proposal, and also for fixing the premium in case the proposal is accepted:- (a) the age of the life insured, (b) his health, (c) his habits and pursuits of life, and (d) his previous history regarding his health.

(h) Insurable Interest

(a) Life Insurance

It has already been noted that a contract of insurance, differs from a contract of wager, because in the case of former the law requires the existence of an insurable interest to support it, which is not necessary in the case of a wagering contract. An *insurable interest*

means that the person effecting the insurance will sustain some pecuniary loss on the happening of the event insured against, viz, the death of the person whose life is insured. Anyone who has pecuniary claim against the other, or a legal right to support from him, has an insurable interest in the life of the other. In the case of life insurance interest need subsist only at the time when the insurance is made, and it need not be continuing on the date of the death of the insured, because, as already seen, life insurance is not a contract of indemnity but only a form of investment. The law recognizes an insurable interest in the following cases:

(1) A person has insurable interest in his ownlife.
(2) A husband in the life of his wife and *vice versa*.
(3) Creditors in life of their debtors.
(4) A surety in the life of the principal debtor, and joint-debtor in each other‘s lives to the extent of half of the debt.
(5) A master in the life of his servant and vice versa.
(6) One partner in the life of another partner.
(7) A trustee, having a legal interest in the life of another, may insure it.

(b) Fire Insurance

An insurable interest in property at risk under fire policy may arise from the natural relationship between the assured and that property, or by operation of law. In England there is a statutory obligation, in certain cases, to insure against fire. In India also certain persons may be required under a statute to insure against fire. Apart from such statutory provisions, an obligation to insure against fire may be created by will or contract. It may be noted that it is not only the legal but also the beneficial owner of the property that possesses an insurable interest therein. Thus (1) tenants who are liable to pay rent after fire, (2) carriers, inn-keepers and wharfingers, for goods entrusted to them , (3) mortgagees , (4) official assignees and official receivers , (5) executors and trustees ; are all held to be persons entitled to insure any property which is insurable and which may be in their charge. It is not necessary that insurable interest should subsist at the time of insurance. It is sufficient, if it exists at the time of the loss.

(c) Marine Insurance

Every person has an insurable interest who is interested in a marine adventure. In particular, a person is interested in a marine adventure where he stands in nay legal or equitable relation to the adventure or to any insurable property at risk therein in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss or damage thereto, or by the detention thereof or may incur liability in respect thereof.

The assured must be interested in the subject matter insured at the time of the loss, though he need not be interested when the insurance is effected. But where the subject matter is insured loss or not lost‘ the assured may recover although he may not have acquired his interest until after the loss, unless at the time of effecting the contract of insurance the assured was aware of the loss and the insurer was not. Where, however, the assured has no interest at the time of the loss, he cannot acquire interest by any actor election after he is aware of the loss.

The following interests are insurable:

(a) A defeasible interest as well as a contingent interest are insurable.
(b) A partial interest of any nature is insurable.
(c) The insurer under a contract of marine insurance and any re- insurance and any re-insurance in respect of it.
(d) The lender of money on bottomry or *respondentia*has an insurable interest in respect of the loan.
(e) The master and crew may insure their wages.
(f) The person advancing the freight has insurable interest in so far as such freight is not repayable in cases of loss.
(g) The assured has an insurable interest in the charges of any insurance that he may effect.

(I) Assignment and Nomination

(a) Life Insurance

An interest in a policy of insurance is property, in the wide sense of the term, and is an actionable claim and can be assigned. Assignment is the method by which property can be transferred either by gift or by sale. It has the effect of directly transferring the rights of the transferor in respect of the policy, and thus it is a transaction which has to be done in accordance with law.

On the other hand, a *payee* or a *nominee* in respect of the money payable under policy of life insurance is an agent to receive that sum. It remains the property of the assured, and will be at his absolute disposal during his life time and forms part of his estate on his death, the payee or the nominee taking no beneficial interest init.

(b) Fire Insurance

There is a general provision regarding transfer of property that every assignee by endorsement or otherwise, of a policy of insurance against fire, in whom the property in the subject insured shall be absolutely vested at the date of assignment shall have transferred and vested in him all rights of suit, as if the contract contained in the policy had been made with himself.

That means the property insured against fire is transferred does not entitle the transferee to claim the benefit of the insurance, unless the policy is also assigned in his favour, whether by an endorsement or by other writing. Here it is clear that once there is such an assignment of the policy and the assignee is the person in whom the property in the subject of policy is vested, he shall have all rights of suit as if the contract contained in the policy has been made with himself.

(d) MarineInsurance

A marine policy may be transferred by assignment unless it contains terms expressly prohibiting assignment. It may be assigned before or after loss, where it has been assigned so as to pass the beneficial interest therein, the assignee is entitled to sue thereon in his own name, and the defendant is entitled to make any defence arising out

of the contract which would have been available to him if the suit had been brought by the person with whom the policy was effected. It may be assigned before or after loss either by endorsement thereon or in any other customary manner.

3. INSURANCE ACT, 2049

This Act was published in 2049 (1992) replacing the Insurance Act 1968 for the purpose of establishing an Insurance Board in order to systematize, regularize develop and control the Insurance business. Now the Insurance Board has got the powers to supervise the operations of the Insurance Companies by promulgating rules in consultation with the Government of Nepal. The Act deals with regulating the insurance companies to comply with insurance Act, Rules and directives rather than laying down the principles of Insurance to be followed. The general principles relating to insurance are developed by Common Law in UK which is generally followed throughout the world. This Insurance Act is also silent about those principles and does not define "Insurance Contact", "Insurable Interest", "Cover Note", etc. The various sections of Act and Rules are discussed below

In this Act, following terminologies are defined as follows:

(a) "Insurer" means a corporate body which is registered under Section 10, the term includes a re-insurer. The insurer cannot be a partnership firm or proprietary concern.

(b) "Insurance Business" means the business of life insurance or general insurance; the term includesre-insurance.

(c) "General insurance business" means fire, marine or miscellaneous insurance business, whether carried on singly or in combination with one or more of them;

(d) "Life Insurance Business" means the business relating to a contract in respect to the life of any person under which he, or his heir in the event of his death, will be paid a specified amount if a specified amount is paid in installments on the basis of hisage.

Under the Indian Insurance Act, "life insurance business" means the business of effecting contracts of Insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of anyevent.

The difference between the two definitions is that in India the money can be paid to any person but in Nepal the money is to be paid to the inured or his heir only. Thus, a creditor or surety on behalf of a debtor can take insurance policy on the life of the debtor in other countries but it is not possible in Nepal.

Under life Insurance Business, an insurer may undertake the following insurance Business:

i. Whole life insurance,
ii. Endowment life insurance, and
iii. Term life insurance

(e) "General Insurance Business" means all other forms of insurance business other than the Life Insurance business. Under general insurance business, an insurer may undertake the following insurance Business:

i. Fire Insurance
ii. Motor Insurance
iii. Marine Insurance
iv. Engineering and contractors Risk Insurance
v. Aviation Insurance
vi. Miscellaneous Insurance

General Insurance is generally divided into marine and non- marine Insurance:

"Marine insurance business" means the business of effecting contracts of insurance upon vessels of any description, including cargoes, freights and other interests which may be legally insured, in or in relation to such vessels, cargoes and freights, goods, wares, merchandise and property of whatever description insured for any transit, by land or water, or both, and whether or not including warehouse risks or similar risks in addition or as incidental to such transit, and includes any other risks customarily included among the risks insured against in marine insurance policies;

"Fire insurance business" means the business of effecting, otherwise than incidentally to some other class of insurance business, contracts of insurance against loss by or incidental to fire or other occurrence customarily included among the risks insured against in fire insurance Policies

f) "Re-Insurance Business" means the business of re-insuring the portion of the risk that is in excess of the risk to be borne by the insurer.

(g) "Insurance policy" means a document mentioning the rights and liabilities relating to the contract of insurance.

(h) "Actuary" means a person who possesses the prescribed qualifications and is appointed by the insurer for purpose of assessing and calculating liabilities relating to insurance business.

(i) "Insured" means any individual or institution holding a life or general insurance policy.

(j) "Insurance Agent" means a person other than a salaried employee of an insurer who has obtained a license under Section 30 to work on behalf of the insurer on the basis of the commission.

(k) "Insurance Broker" means an individual who has obtained a license under Section 30B to work as an intermediary between insurers in connection with the insurance Business.

(l) "Surveyor" means a person who has obtained a license under Section 30A to make financial valuation of the damaged property; the term includes an adjuster and a person who makes a valuation of losses.

FORMATION OF THE BOARD [SEC. 3 & 4]

Insurance as a form of mitigating risk goes back a long time, almost as far back as commerce itself. It certainly pre-dates central banking. Yet the International Association of Insurance

Supervisors (IAIS) representing insurance regulators and supervisors worldwide (currently, some 190 countries are members) came into existence only in 1994. In contrast, the bank for International Settlements, the apex body for central banks, was established in 1973.

Not surprisingly, therefore, the IAIS has a fair amount of catching up to do in terms of formulating uniform guidelines in respect of standards and principles in the insurance sector. Fortunately, its effort in this direction coincide with the opening up of the insurance sector in Nepal and the evolution of the insurance regulator, the Insurance Board (IB) as a mature regulatory body.

Hence, rather than re-invent the regulatory wheel as it were, in many areas, the IB may take a leaf out of the IAIS' book while framing its own bye-laws

Insurance Board shall consist of the following members:

(a)	A person nominated byGovernment of Nepal	-Chairperson
(b)	Representative, Ministry of Law, Justice and Parliamentary Affairs	-Member
(c)	Representative, Ministry of Finance	-Member
(d)	A person nominated by Government of Nepal from among persons specializing in insurance business	-Member
(e)	A person nominated by Government of Nepal from among insured	-Member

Government of Nepal may make changes in the members of the Board by publishing a notification in the Nepal Gazette, if it deems necessary. The term of nominated members is four-years. But they may be re-nominated for not more than two terms after the expiry of their term. Thus, a nominated person may continue to be member of the board for a maximum of 12 years.

The Board is an autonomous body with powers to acquire, sell or otherwise dispose off movable or immovable property and may sue or be sued in its own name.

Meetings

- Meetings shall be called for a date, time and at a place notified by the Chairperson.
- There shall be at least two meetings in a quarter and a minimum of eight meetings in a year.
- The meeting shall be presided over by the Chairperson, and in his absence, a person among Board Members chosen by themselves.
- The quorum for the meetings shall be 50% of its total members, and the opinion of the majority shall be binding.
- The chairperson shall be the Chief Executive Officer and shall be a person who has specialized in insurance business and shall have entire power & responsibility to implement the decision of the board and supervise and control its functions.
- The term of office of the Chairperson shall be four years and he may be re- appointed or re-designated.

Functions, Duties and Powers of the Board

The functions, Duties and powers of the Board shall be as follows:

- To offer necessary suggestions to Government of Nepal to formulate policies for systematizing, regularizing, developing and controlling the insurance business.
- To formulate policies and fix priority sectors for investing the insurance proceeds.
- To register and renew (the certificates) of insurers, insurance agents, surveyors, or brokers, and cancel such registration, or make arrangements for doing so.
- To mediate in disputes between the insurer and the insured.
- To take decisions on complaints filed by the insured against the insurer in regard to the assessment of the insurance liability.
- To issue necessary directives to the insurers from time to time in regard to the insurance business.
- To formulate necessary criteria for protecting the interest of the insured; and
- To perform or make arrangements for performing other necessary functions relating to the insurance business.

REGISTRATION OF INSURERS AND CANCELLATION OF REGISTRATION

Registration of Insurers [Sec.10]

No one shall engage in or make arrangements for engaging in the insurance business without obtaining a certificate under thisact. Any national or foreign corporate body desirous of engaging in the insurance business shall apply to the office of the Board in the prescribed form along with the following documents and the prescribed fees in order to have its name registered as an insurer:

(a) Memorandum and Articles of Association of the corporate body,
(b) Insurance business sought to be undertaken, and its policies and terms,
(c) In the case of life insurance business, documents indicating calculations of premiums to be received in the course of that business, and of liabilities,
(d) Documents indicating the methods of utilizing amounts received through insurance, and
(e) Other necessary documents prescribed by the Board.

On the receipt of an application pursuant to above, the Board shall, after conducting necessary investigations into the application and making inquiries, if necessary, with the applicant, register the name of the applicant in the prescribed register, and grant a certificate of insurer to it in the prescribed form by mentioning the category of insurance business which it may undertake. In case there is any satisfactory reason for not so registering its name, the Board shall inform the concerned applicant accordingly.

Notwithstanding anything contained elsewhere in this section, in the case of life insurance, the Board shall issue a certificate to operate the business on the basis of the fulfillment of the criteria determined from time to time in relation to the operation of the insurance business, and with the approval of Government of Nepal.

Application to be submitted for registration as insurer (Rule7)

(1) Any national or foreign corporate body desirous of engaging in insurance business shall submit an application to the office of the Board in the form indicated in schedule 1 along

with an insurer's registration fee amounting to Rs.50,000/- in order to have its name registered as an insurer.

(2) The corporate body applying under Sub-Rule (1) shall submit necessary documents which substantiate the following particulars in addition to the documents mentioned in Sub-Section (2) of the Section of the Act:
   (a) The total liability to be assumed by the corporate body while engaging in the insurance business is not in excess of its total assets.
   (b) In the case of foreign corporate body, the evidence that it has adequate assets inside Nepal in its own name so as to bear the total liability of insurance business to be undertaken by it within the Nepal.
   (c) A certificate explicitly mentioning the name, address and the qualifications of the General Manager, who bears the responsibility in the capacity of Chief in regard to insurance business conducted on behalf of the corporate body.
   (d) In the case of corporate body registered as a foreign insurer, the certificate obtained from the empowered authority of the concerned foreign country to engage in insurance business according to the prevailing laws of that country.

Certificate to be issued after registration of the name of insurer (Rule 8)

(1) On receipt of an application submitted by any national or foreign corporate body for the registration of its name as an insurer under Rule 7, the Board shall conduct necessary investigation into the application and also make inquiries, if necessary, in respect to any matter with the applicant, and register the name of the applicant as an insurer in the register maintained in the form indicated in Schedule 2.

(2) After registering the name of the applicant in the register under Sub- Rule (1), the Board shall issue a certificate in the form indicated in Schedule 3 also specifying the category of insurance business which the applicant corporate body may undertake.

Permission to be obtained to expand insurance business (Rule 17)

In case any insurer desires to undertake any insurance business other than those for which it has received permission while obtaining the certificates, it shall obtain the permission of the Board. In case any insurer desires to expand its insurance business by opening additional branch offices, it shall obtain the permission of the Board.

Renewal of Registration of the insurer [Sec.11]

The insurer shall apply to the office of the Board in prescribed form along with the prescribed fees by the end of the last day of Chaitra every year in order to have its certificate of registration renewed. On the receipt of an application, the Board shall renew the certificate of registration.

In case any insurer submits an application to the Board within thirty days from the date of expiry of the time limit mentioned as above by explicitly mentioning the reason for its failure to submit an application for the renewal of its registration certificate within the said time limit, the Board may, if it considers the reasons to be appropriate, renew the registration certificate of such Insurer.

Arrangements relating to renewal of certificates (Rule 9)

(1) For the purpose of having its certificates renewed, an Insurer shall submit an application to the office of the Board in the form indicated in Schedule 4 within the time-limit mentioned in Section 11 of the Act along with a renewal fee amounting to Rs.50,000.

(2) In case the head office of an Insurer who has applied for renewal under Sub-Rule (1) is located outside Nepal, the concerned foreign insurer shall enclose along with the application for renewal to be submitted under this rule, the evidence of the renewal of the certificate obtained by it to engage in insurance business according to the current laws of the authority of that country.

(3) In case any insurer submits an application for the renewal of its certificate under this rule after the expiry of the time-limit prescribed in Sub-Section (3) of section 11 of the Act, by explicitly mentioning the reason for its failure to submit an application for the renewal of its registration certificate within the said time limit, the Board may, if it considers the reasons to be appropriate, renew the registration certificate of such Insurer.

Circumstances When Registration Certificates of Insurers Cannot be renewed

Notwithstanding anything contained in Section 11, the Board shall not renew the certificate of registration of an Insurer in any of the following circumstances:

(a) In case it does not submit the balance sheet according to Section 23.
(b) In case it does not submit the statement of income according to Section 24.
(c) In case it does not submit the auditor‘s report according to section 25.
(d) In case it does not submit the Actuary‘s report according to Section 26.
(e) In case it does not pay the insurance service fee according to Section 40.
(f) If it has been prohibited to operate the insurance business pursuant to section 12 A.

In the case of certificate of registration of an Insurer cannot be renewed because of any of the circumstances mentioned as above, the Board shall notify the insurer accordingly within 15 days from the date of emergence of such circumstances.

In case the Insurer submits an application to the Board within 15 days from the date of receipt of a notice by explicitly mentioning appropriate reasons for its inability to fulfill the obligations to be fulfilled by it under Section 23, 24, 25, 26 and 40,the Board may, if it considers the reasons to be appropriate, provide an additional time limit of not more than one month to fulfill those obligations.

Denial of Registration [Sec. 12]

Notwithstanding anything contained in Section 10, no national or foreign corporate body shall be registered as an Insurer in the following circumstances:

(a) In case any proposed insurer wants to register itself under a name identical to that of an Insurer which has already been registered at the office of the Board.
(b) In case any proposed Insurer wants to be registered for operating both life and general insurance business. However, in case any Insurer has been operating life and general insurance business after being registered before the commencement of this Act, it shall

operate life insurance and general insurance business through separate institutions as prescribed with effect from the date prescribed by the Board.

(c) If the paid up capital does not amount to at least two hundred fifty million rupees for the Life Insurance Business and to at least one hundred million rupees for the Non-life Insurance Business. Using the power given by section 8(d2) of the Act, the Insurance Board has directed that the paid up capital shall be at least Rs. 2.0 billion rupees for the Life Insurance Business and at least Rs. 1.0 billion rupees for the Non-life Insurance Business (decision dated 31st March, 2017).

(d) In the event that the Board has made a decision to ban to register to additional corporate body as an Insurer to operate Insurance Business on the basis of the report regarding to the study, research and evaluation of the Insurance Business market.

Ban on Insurance Business [Sec. 12A]

The Board may impose a full or partial ban on or cancel any type of business being undertaken by an insurer under its insurance business in any of the following circumstances:

(a) In case the Insurer violates the directives issued by the Board from time to time in regard to procedures to be followed while operating the insurance business.

(b) In case the insurer supplies loans to any corporate body in which any of its directors or their families are working as managing agents or partners, or provides guarantee or security of any kind for any loans supplied to them by others, in violation of Section 14.

(c) In case the insurer does not furnish the information to be furnished by it to the Board under Section 15.

(d) In case the Insurer does not maintain its accounts and records properly according to Section 19.

(e) In case the insurer does not maintain separate accounts and records according to Section 20.

(f) In case the Insurer does not maintain the fund to be maintained by it under Section 21, or in case it bears the liabilities of one insurance business from the fund maintained for another business.

(g) In case the Insurer does not maintain the reserve fund to be maintained by it on a compulsory basis under Section 22.

(h) In case the Insurer accepts the insurance risk without obtaining the insurance premium under Section 27.

(i) In the case the Insurer does not re-insure according to Section 28.

Before imposing a ban on the insurance business of an Insurer pursuant to above, the Board shall provide an appropriate time limit to the concerned Insurer for submitting its explanations, explicitly mentioning the reasons for imposing such ban on its insurance business.

In case the concerned Insurer does not submit its explanations within the prescribed time limit, or in case the explanations submitted by it are not found to be satisfactory, the Board may impose a ban on the insurance business of the concerned Insurer and publish a notice thereof into prominent newspapers published from Nepal for the information of the public.

During the period when a ban has been imposed on the insurance business of any Insurer, the concerned Insurer shall settle in the prescribed manner the claims of compensation filed

againstit. In case a ban is imposed on the insurance business of any Insurer under this Section, the Board may, if it finds the evidence submitted by the Insurer within the prescribed time-limit by stating that the circumstances requiring the imposition of a ban on its business no longer existed, to be satisfactory, impose a fine as prescribed and lift the ban.

Lifting of ban imposed on insurance business (Rule 11A)

(1) Within 35 days after the end of the circumstances as a result of which a ban on the insurance business of an Insurer has been imposed under Section 12A of the Act, the concerned insurer shall submit an application along with necessary evidence to the Board stating that the circumstances which required such a ban no longer exist.
(2) In the case of the circumstances mentioned in the application filed under Sub-Rule (1), and the evidence submitted along with that application are found to be satisfactory, the Board may lift the ban imposed on the insurance business. While doing so, the board may fine the Insurer with Rs. 10,000 in case the ban to be lifted is a partial one, and with Rs. 25,000/- in case the ban is a full one.

Explanation

For the purpose of this rule,

(1) Full ban means a ban imposed in such a manner as to prohibit the insurer from conducting his entire transactions concerning the insurance business.
(2) Partial ban means ban imposed in such a manner as to prohibit the insurer from conducting any one or more transactions from among his entire transactions concerning the insurance business.

Cancellation of Registration [Sec. 13]

The Board may cancel the registration of an Insurer by notifying it in writing with effect from the date prescribed in the notice in the following circumstances:

(a) In case the insurance business is not commenced within six months after obtaining the certificate.
(b) In the case it is felt that the liabilities of the Insurer exceeds his assets inside Nepal.
(c) In case litigation arises in any insurance policy issued inside Nepal and the insurer fails to meet its obligations even within three months according to the final judgement of the Court.
(d) In case the head office of the insurance business of any foreign Insurer is situated outside Nepal and in case it felt that Nepali Insurers have not been provided there with facilities equivalent to those enjoyed by the foreign insurer there according to the law of that country.
(e) In case the Insurer does not open its office inside Nepal.
(f) In case the Insurer does not perform any function which it is required to perform under this Act or the rules framed here under, or performs any functions which is prohibited under this Act or the rules framed here under.

Before canceling the registration of an Insurer, the Board shall provide it with a reasonable time-limit to submit explanations, explicitly mentioning the reasons for canceling its registration. In case the concerned Insurer does not submit its explanations before the mentioned time-limit or in case the explanations submitted by it are found unsatisfactory, the Board shall cancel the

registration of such Insurer and publish a notice thereof in two prominent newspapers published from Nepal for the information of the public.

Mere cancellation of the registration of an Insurer under this Section shall not make any impact on the rights and liabilities of concerned Insurer in respect to any action taken or function performed before such cancellation.

In case an Insurer is dissolved as a result of the cancellation of its registration, Government of Nepal may appoint a Liquidator.

Settlement of Insurance Claims after the Cancellation of Registration of an Insurer

In case any Insurer is dissolved as a result of the cancellation of its registration under Section 13, the concerned Insurer shall refund the amounts received by it in the course of insurance to the policy-holding individuals and institutions or the Board within the time-limit and according to the procedure prescribed by the Board. In the case of the life insurance business, it shall refund the principal amount along with bonus as prescribed by the Board, while in case of general insurance business, it shall refund the principal amount prescribed by the Board on proportionate basis.

Insurer to be liable [Sec. 17]

(1) In case the Insurer, or its employees, insurance agents or surveyors cause losses to the policy-holders by taking any action against their rights and interests, the Insurer must pay compensation for such losses.
(2) In case the Insurer fails to pay compensation under Sub-Sec(1), or to determine within the prescribed time-limit the liability in respect to insurance claims and compensation, or determines liability in sucha manner as to aggrieve him, the concerned insured may file a complaint with the Board in the prescribed manner.
(3) In case a complaint is filed under Sub-Section (2), the Boardshall conduct necessary investigations into the complaint and provide a reasonable opportunity to the Insurer to submit its explanations in connection with the complaint.
(4) In case the explanations submitted by the Insurer under Sub-Section (3), are found reasonable, the Board may cancel the complaint after explicitly mentioning the grounds for doing so. In case the explanations are found unsatisfactory, the Board shall decide in favor of payment of compensation to the employment.
(5) In case the Board decides in favor of payment of compensation to the complainant under Sub-Section (4), the insurer must pay such compensation to the insured.
(6) In case an appeal is filed against the decision taken by the Board entitling the applicant to compensation under Sub-Section (4), and the decision is endorsed, the concerned Insurer shall, immediately pay to the Insurer the amount of compensation along with interest from the date of the initial decision to the date of final disposal of the case thereon at the prescribed rate.

Order of Priority in settlement of liabilities [Sec. 41B]

In case any insurer is dissolved because of the cancellation of its registration under Section 13, it shall settle its liabilities on the basis of the following order of priority:

(a) Expenses incurred for the purpose of dissolution;
(b) Amounts to be paid against claims to the insured under Section16;
(c) Remuneration and other outstanding amounts to be paid to the employees of the insurer;
(d) Loans;
(e) Amounts to be paid to the Board;
(f) Amounts to be paid to Government of Nepal.

Comment: It may be noted that all the taxes due to Government of Nepal is the last in the priority list and after liquidation expenses, the amount to be paid to the insured persons against their claims takes priority over other creditors.

RESTRICTIONS ON LOANS & INVESTMENTS

Loan, Guarantee or Security not to be provided to Directors [Sec. 14]

No Insurer shall provide loans to its Directors, their families or any corporate body in which they are working as managing agent or partner, or provide guarantee or security in any form when any person provides them with loans. However, this Section shall not apply to loans supplied to the extent of the surrender value of insurance policy issued by the insurer.

Notice to be Furnished [Sec. 15]

In case the Insurer conducts any transaction relating to insurance business with its Directors or their families or any corporate body in which they are working as Managing Agent or partner, it shall submit a notice thereof to the Board within 35 days.

Permission to be obtained by Insurer while making Investments in other fields(Rule 12)

An Insurer shall obtain the prior approval of the Board in order to make Investments in fields other than those prescribed by Board.

Prohibition to Supply Loans or Make Investments (Rule 13)

Notwithstanding anything contained elsewhere in these rules, an Insurer shall not supply loans or make investments of any kind in any corporate body in which any member of its Board of Directors is functioning as a director or has financial interest.

Explanation: In case an Insurer's Director or any member of his undivided family has purchased shares amounting to 10 percent or more of the paid-up capital of any company or corporate body either jointly or separately, concerned Director shall be deemed to have a 'financial interest' in that company or corporate body for the purpose of this rule.

It may be noted that who are family members is not defined in the Act and the definitions in the prevailing laws shall be referred to for the purpose.

Further, the Insurance Board has issued a directive as to what investments can be made by the insurance companies in respect of life insurance and non-life insurance.

ACCOUNTS AND RECORDS

Accounts and Records of Insurer [Sec. 19]

The Insurer shall maintain its accounts and records according torules(norms). The accounts and records maintained under Sub-Section (1) shall clearly indicate every item of income and expenditure of the Insurer along with detailed particulars of its assets and liabilities, so that they correctly reflect the financial condition of its business.

Management Expenses of the Insurer (Rule16)

The Insurer may spend up to twenty five percent in the case of Marine Insurance and up to thirty percent in the case of other Insurance for the management functions out of the total amount of the income generated from the premium while operating the Insurance Business. However, the amount spent for the initial establishment and mechanization of the Insurance office shall not be included in the management expenses

Separate Accounts to be Maintained [Sec. 20]

In case any Insurer undertakes another business concurrently with insurance business, it shall maintain separate accounts of its insurance business. Any Insurer who undertakes more than one insurance business shall maintain accounts of each category of insurance business separately.

No any company is allowed to conduct two types of insurance under the same company and under Rule 15A, there shall be separate companies for each type of insurance business and the existing companies shall also differentiate their insurance businesses, if any, into separate companies from the date fixed by the Board. But any new registration is granted to one company for conducting either life or no-life insurance business only.

But the directives recently notified for life insurance companies indicates that separate accounts have to be maintained for each type of insurance even within the Life assurance for example, Insurance of term life policy, Endowment Policy and single premium policy.

Balance Sheet to be submitted [Sec. 23]

The Insurer shall publish the balance sheet and profit and loss account relating to its entire insurance business, and also submit a copy thereof to the Board, within six months after the expiry of each financialyear. In case any Insurer submits an application to the Board requesting for an extension of the time limit for submitting the balance sheet and profit and loss account showing satisfactory reasons for its inability to do so within that time limit, the Board may extend the time limit by not more than a month.

Accounts of income to be submitted [Sec. 24]

The Insurer shall prepare separate accounts of income made by it from its different categories of insurance business inside Nepal in the form prescribed by the Board and submit them to the Board within six months after the expiry of each financialyear. In case any Insurer submits an application to the Board requesting for an extension of the time limitfor submitting the accounts

of its income showing satisfactory reasons for its inability to do so within that time limit, the Board may extend the time limit by not more than a month.

Audit [Sec. 25]

The Insurer shall have the accounts and records of the insurance business undertaken by him audited by an auditor recognized under prevailing law, and submit a report thereof to the Board within 10 months from the date of expiry of each financial year. The report must include matters in respect to which clarifications have been sought (inconsistencies and irregularities) in the course of audit, as well as the clarifications given by the management in respect there to.

In addition, the Insurance Board has prescribed a Long Form Audit report to be submitted by the auditor to the Insurance Board in line with the directives by the Nepal Rastra Bank, in the case of banks and financial institutions. The long Form audit report requires the auditor to give his planning of audit, a declaration about his independence, the auditing standards followed by the auditor, the constitution of audit team, audit findings and the time taken for audit and other particulars relating to audit carried out.

INSURANCE FUND

Insurance Fund [Sec. 21]

An Insurer shall maintain a separate fund for each category of insurance business and the amounts received from (each category) insurance business shall be credited to the concerned fund. The fund maintained for one category of insurance business shall not be utilized to bear liabilities relating to any other category of insurance business.

Compulsory Reserve Fund [Sec. 22]

Every Insurer shall maintain a reserve fund as prescribed by the Board to meet the liabilities pertaining to its insurance business inside Nepal.

Amounts to be deposited in the Reserve Fund (Rule 15)

An Insurer shall credit the following amounts in the reserve fund established under Section 22 of the Act in order to meet the liabilities relating to its insurance business within Nepal:

(a) Amounts not less than the total liability prescribed by the actuary on the basis of insurance policies issued within Nepal by an Insurer engaged in life insurance business.
(b) Amounts not less than 50 percent of the net insurance premium shown in the statement of income and expenditure of general insurance business.
(c) 50 percent of the profits earned until the amount equals the paid-up capital of an Insurer engaged in general insurancebusiness. However, in the case of marine insurance, the amounts credited to the reserve fund for at least three years shall not be considered to be profit.
(d) Amounts equal to 115 percent of the amounts outstanding in consideration of payment against claims made by an Insurer before the expiry of each financial year.

Capital of Insurers

As in any other business, capital reduces the likelihood of failure due to significantly adverse losses incurred by insurers over a defined period, including declines in the value of assets and/or increases in the obligations of the insurer, and also reduces the magnitude of losses to policyholders in case the insurer fails.

From regulatory perspective, the purpose of capital is to ensure that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due. While doing so, regulators have to juggle between maintaining adequate capital that will enhance the safety and soundness of the insurance sector and of the financial system generally, while not increasing the cost of insurance to beyond its economic value to policyholder and unduly inhibiting the insurer's ability to compete. Followings are the features of an ideal regulatory capital regime:

1. Regulatory capital requirements should be established at a level such that the amount of capital an insurer is required to hold should be sufficient to insure that, in adversity, an insurer's obligations to policyholders will continue to be met as they fall due.
2. A total balance sheet approach should be used to recognize the interdependence between assets, liabilities, regulatory capital requirements and and capital resources and to ensure that risks are appropriately recognised.
3. The solvency regime should include include a range of solvency control levels that trigger different degrees of intervention by the supervisor in a timely manner. This regime should have due regrd to the coherence of the solvency control levels and any associated corrective action that may be at the disposal of the insurer, and the supervisor, including option to reduce the risks being taken up by the insurer as well as to raise more capital.
4. The solvency regime should allow a range of approaches for determining regulatory capital requirements, including standardised approaches and, subject to the approval of the supervisor, internal models. This parallels the Basle II approach in case of banks.
5. The solvency regime should be explicit regarding the risks addressed in technical provisions and in regulatory capital requirements. The regime should also be explicit as to how risks and their aggression are reflected in regulatiry capital reguirements.
6. The supervisor should set out appropriate target criteria such as the confidence level, risk measure and time horizon) for the calculation of regulatory capital requirements, which should underlie the caliberation of a standardised approach.
7. The solvency regime should be open and transparent about regulatory capital requirements and explicit about their objectives and the basis on which they are determined (including the level of safety, risk measures used and time horizon that under pin then).

PREMIUMS

Rates of Premium (Rule 18)

(1) The Insurance Tariff Advisory committee shall offer necessary advice to the Board in order to fix the rates of premium that an Insurer may collect from the insured while undertaking insurance business

(2) No Insurer may undertake insurance business by determining premium rates that differ from the rates prescribed by the Board in consultation with the Advisory Committee under Sub-Rule(1).

(3) In case any Insurer operates or makes arrangements for operating the insurance business by altering the rates of insurance premium determined by the Board under Sub-Rule (2), the Board may impose a full or partial ban, or cancel the insurance business being operated by the Insurer, and arrange for the transfer of such insurance business to any Insurer who was operating such insurance business prior to that, or to any other Insurer in case there is no such previous Insurer.

Insurance Premium to be paid before Assuming Risks [Sec. 27]

No Insurer shall assume insurance risks until it receives premiums to be collected while undertaking insurance business of any category. The Insurer shall be deemed to have taken up an insurance business only after it receives insurance premiums for having assumed risks.

However, in case any practical difficulty arises for any reason in paying the entire amount in lump sum, this Section shall not be deemed to have prohibited the issue of an insurance policy on the guarantee of a bank or Government of Nepal in regard to the payment of the outstanding amount within a specified period.

Transaction not to be Recognized until Insurance Premium is Paid (Rule 36C)

Until the Insured pays to the Insurer the insurance premium payable by him for effecting the insurance, no transaction relating to insurance shall be deemed to have been effected between them.

Insurance Tariff Advisory Committee [Sec. 41]

For the purpose of offering necessary advice and suggestions to the Board in determining insurance rates of insurance business, Government of Nepal shall form an Insurance Tariff Advisory Committee compromising the following members:

(a) Chairperson, Insurance Board -Chairperson
(b) Three persons nominated by Government of Nepal from among the chiefs of the Insurers - Members
(c) Secretary, Insurance Board -Member Secretary

The working procedures relating to the meetings of the Advisory Committee shall be as determined by the Committee itself. The functions, duties and powers of the Advisory Committee shall be as prescribed.

INSURANCE AGENTS, SURVEYORS AND BROKERS

Provisions Relating to (Registration of) Insurance Agents

Registration of Insurance Agents

Any person desirous of working as an Insurance Agent and possessing qualifications as prescribed shall apply to the Board along with the recommendations of the concerned Insurer.

On the receipt of an application, if it so deems appropriate after conducting necessary investigations into the application, grant a license of insurance agent to the applicant in the

prescribed form after collecting theprescribed fees, and in case there is any reason for not so granting a license, the Board shall inform the applicant accordingly.

Application to be submitted for Insurance Agent's License (Rule 19)

In case any person who possesses the qualifications mentioned in Rule 21 desires to work as an insurance agent, shall submit an application to the office of the Board in order to a license of an insurance agent in the form indicated in Schedule 7, along with the recommendation of the concerned Insurer.

Grant of Insurance Agent's License (Rule 20)

(1) On receipt of an application for a license to work as an insurance agent under Rule 19, the Board shall conduct investigation to find out whether or not the applicant possesses the qualifications mentioned in Rule 21 and, if it deems appropriate to issue an insurance agent's license to the applicant, register the applicant's name in the register maintained in the form indicated in Schedule 8.

(2) After registering the name of the applicant in the register under Sub-Rule (1), the Board shall collect a fee of Rs.500/- payable by the applicant for an insurance agent's license and issue a license in the form indicated in Schedule 9 by explicitly mentioning the insurance business in respect to which he may work as an insurance agent.

Qualification of an Insurance Agent (Rule 21)

Any person who desires to apply for an Insurance Agent's License under Rule 19 shall possess the following qualifications:

(1) Having passed at least SLC or the equivalent examination,
(2) Having received a certificate being a participant and completed the training for the Insurance Agent conducted by the Board or an organization recognized by the Board.
(3) If an applicant is a corporate body, any one director of that corporate body shall have possessed the qualification as referred to in (1) and (2).

Renewal of Insurance Agent's License (Rule 22)

(1) For the purpose of having his license renewed, an insurance agent shall submit an application to the office of the Board in the form indicated in Schedule 10 along with a renewal fee of Rs. 200 within the time-limit prescribed in Sub-Section (1) of Section 31 of the Act. On receipt of such application, the Board shall renew the license of such insuranceagent.

(2) In case an insurance agent submits an application to the Board office explaining the reason for his failure to apply for renewal of his license within the time-limit mentioned in Sub-Rule (1), the Board may, if it is satisfied with the reason, renew the license of such insurance agent after collecting an additional fee amounting to Rs. 100 for the first two months after the expiry of the time-limit for renewal, and at the rate of Rs.5/- per day for the next four months.

Commission to be paid to Insurance Agent (Rule23)

(1) No insurance agent shall be paid commission in excess of following amount from the premium to be paid by the insured:

(a) Commission as mentioned in Schedule 11, in respect to life insurance.
(b) Commission as prescribed by the Board, in respect to general insurance.

(2) Notwithstanding anything contained elsewhere in these rules, an insurer may pay an incentive bonus to insurance agents in addition to the commission mentioned in Sub-Rule (1).

Commission payable to Life Insurance agent is given in Schedule 11 to the regulations under various circumstances depending on the nature and period of life policy.

Commission to be Paid for the Period of Work (Rule 24)

Even if the license of an insurance agent is cancelled owing to his failure to renew it under Section 33 of the Act, the Insurer shall pay the commission due to him under Rule 23 in case he has done any work relating to insurance business before the period during which he has failed to renew his license.

Commission to be Paid to Heir (Rule 25)

In case an insurance agent dies before obtaining the commission due to him under these rules, it shall be paid to his heir.

Provisions Relating to (Registration of) Surveyors

Registration of Surveyors

Any person desirous of working as a Surveyor and possessing the prescribed qualifications may submit an application to the Board in the prescribedmanner. On receipt of an application, the Board shall, if it deems it appropriate to issue a license following necessary investigations into the application, collect the prescribed fees, and issue of Surveyor‘s license to the applicant in the prescribed form. In case there is any reason while such a license must not be issued, the Board must inform the applicant accordingly.

Application to be submitted for a Surveyor‘s License (Rule 26)

In case any person who possesses the qualifications mentioned in Rule 28 desires to work as a surveyor under Sub-Section (1) of Section 30 A, he shall submit an application to the office of the Board in the form indicated in Schedule 12 for a license.

Surveyor‘s License to be issued (Rule 27)

(1) On the receipt of an application under Rule 26 for a surveyor‘s license, the Board shall conduct investigations to find out whether or not the applicant possesses the qualifications mentioned in Rule 28, and, if it deems it appropriate to issue a surveyor‘s license to him, register his name in the register maintained in the form indicated in Schedule 13.
(2) After registering the name of an applicant in the register under Sub-Rule (1),the Board shall collect Rs.12,000 for a class ‘A’ license, Rs. 9,000 for class ‘B’ license, Rs 7,000 for a class “C” license and Rs. 5,000 for class ”D” license as provided for in Rule 28 (A), as license fee from the applicant and issue him a Surveyor‘s license in the form indicated in Schedule 14.

Qualifications of Surveyor's (Rule 28)

Any person desirous of applying for a surveyor's license under Rule 26 shallpossess the following qualification:

(1) He shall have gained at least 10 years'experience of work relating to insurance business at an officer level post of an office of insurer.
(2) He shall have obtained a graduate degree in engineering.
(3) *He shall have at least a **Bachelor Degree in Insurance** subject from a Chartered Insurance Institute of international standard or from an organization recognized by such institute*
(4) He shall have passed the Chartered Accountancy examination.

Classification of Surveyors (Rule 28A)

All such surveyors as have been working as such after obtaining surveyor's license and thus completed the following periods of work shall be classified as follows and issued surveyor's license after the commencement of this rule:

(a) Surveyor who has been regularly working as such for more than 15 years: Class A
(b) Surveyor who has been regularly working as such for 10 to 15 years: Class B
(c) A Surveyor who has regularly worked as a Surveyor for a period From five to ten years, Class "C".
(d) A Surveyor who has regularly worked as a Surveyor for a period of five years, Class "D".

Arrangements Relating to Renewal of Surveyor's License (Rule 29)

(1) For the purpose of having his license renewed, the Surveyor shall submit an application to the office of the Board in the format of Schedule-15 along with the renewal fee of twelve thousand Rupees for "A" class license, nine thousand Rupees for "B" class license, seven thousand Rupees for "C" class license and five thousand Rupees for "D" class license within the time-limit pursuant to subsection (1) of Section 31 of the Act for the renewal of the License. On receipt of such application, the Board shall renew the Surveyor's license.
(2) In case any surveyor submits an application to the office of the Board explaining the reason for his failure to apply for renewal of his license within the time-limit prescribed in Sub-Rule (1), the Board may, if it is satisfied with the reason, renew such license by collecting an additional fee amounting to Rs.500 for the first two months after the expiry of time- limit for renewal, and at the rate of Rs. 50 per day for the next four months.

Provisions Relating to (Registration of) Brokers

Registration of Brokers (Sec. 30B)

Any person desirous of working as a Broker and possessing the prescribed qualifications must submit an application to the Board in the prescribedmanner. On receipt of an application, the Board shall, if it deems it appropriate to issue a license following necessary investigations into the application, collect the prescribed fees, and issue of Broker's license to the applicant in the prescribed form. In case there is any reason while such a license must not be issued, the Board shall inform the applicant accordingly.

Application to be filed for a broker‘s license (Rule 30A)

Any person who wishes to work as a Broker under Section 30B of the Act and who possesses the qualifications mentioned in Rule 30C shall submit to the office of the Board an application for a broker‘s in the form indicated in Schedule 17.

Broker’s License to be Issued (Rule 30B)

On receipt of an application for a broker‘s license under Rule 30A , the Board shall examine as to whether or not the applicant possesses the qualifications prescribed in Rule 30C, and, if it deems it appropriate to issue him a Broker‘s license, register his name in the register maintained in the form indicated in Schedule 18.

After registering the applicant’s name in the register, the Board shall collect a fee of Rs. 25,000 for a broker‘s license and issue him a broker‘s license in the form indicated in Schedule 19.

Qualifications of Brokers (Rule 30C)

Any person applying for broker‘s license shall have fulfilled the following conditions:

(1) It shall have to be recognized as a corporate body pursuant to prevailing law.
(2) The authorized capital of the corporate body must amount to the figure prescribed by the board.
(3) Twenty five percent of the total authorized capital of the corporate body must have been deposited in fixed deposit account of any commercial bank.
(4) The person working as the General Manager of the corporate body must have gained 15 year‘s experience in functions relating to insurance.
(5) All other conditions prescribed by the Board must also be fulfilled.

Provisions Concerning Renewal of Broker’s License (Rule 30D)

(1) For the purpose of having his license renewed , a broker must, submit an application to the office of the Board in the form indicated in Schedule 20 alongwith the renewal fee of Rs. 25,000 within the time-limit prescribed in Sub-Section (1) of Section 31 of the Act.
(2) In case any broker is unable to submit an application for the renewal of his license within the time limit mentioned in Sub- Rule (1), and, therefore, submits an application to the office of the Board explicitly mentioning the reasons for his inability to do so, the Board may, if it considers those reasons to be appropriate, renew his license by collecting an additional fee of Rs. 5,000 during the first two months after the expiry of the time-limit for renewing the license , and Rs. 200 per day during four months there after.

Power to Impose Ban on the Issue of Broker‘s license (Rule 30E)

Notwithstanding anything contained elsewhere in these rules, the Board may impose a ban on the issue of a broker‘s license to anyone for working as an intermediary between insurers for any specified period on the basis of a study, research and evaluation of market relating to insurance business.

Cancellation of Broker's License (Rule 30F)

In case the license of a broker is cancelled under Section 33 of the Act, another license to work as a broker shall not be issued to him for five years from the date of such cancellation.

Validity and Renewal of license (Agents/Surveyors/Brokers) [Sec. 31]

Insurance Agents, Surveyors or Brokers shall, for the purpose of having their license renewed, apply to the office of the Board in the prescribed form along with the prescribed fees before the last day of Chaitra every year.

In case an insurance agent, surveyor or broker submits an application mentioning the reason for his in ability to apply for the renewal for the license within the time-limit mentioned above and in case the Board finds the reason satisfactory, the Board may extend the time- limit by not more than six months after collecting the prescribed additional fees.

Disqualifications (Agent/Surveyor/Broker) [Sec. 32]

No person can become an insurance Agent, Surveyor or Broker in the following circumstances:

(a) In case he has not attained the age of 16 years,
(b) In case he is of unsound mind,
(c) In case he has been declared insolvent and bankrupt,
(d) In case he has been convicted by the court on the charge of any kind of theft or cheating, or of having misused or misappropriated property held in his custody, and has been punished accordingly,
(e) In case he has done anything in the course of work relating to insurance business causing loss damage to the insurer or to any insurance policy holder.

Cancellation of License (Agent/Surveyor/Broker) [Sec. 33]

In case any insurance agent, surveyor or broker does not renew his license under Section 31, or in case the Board is satisfied that he has done anything committed any action in contravention of this Act or the rules framed hereunder, or against the rights and interests of insurance policy holders, the Board may cancel his license.

However, before so canceling a license as above, the Board shall provide a reasonable time-limit to him (insurance agent, surveyor or broker) to submit his explanations in respect to the charges leveled against him.

FUNDS AND AUDIT OF THE BOARD

Funds of the Board [Sec. 34]

The Board shall have a separate fund of its own, which shall compromise the following amounts:

(a) Amounts received from Government of Nepal,
(b) Amounts received from any foreign government or international organization orassociation,
(c) Amounts received as registration and renewal fees, etc from insurers, insurance agents or surveyors,

(d) Amounts received from service charges,
(e) Amounts received from any other source.

The entire expenses to be incurred on behalf of the Board shall be borne from the amounts credited to the fund of the Board mentioned in Section 34.

Accounts and Audit [Sec. 35]

The Board shall accurately maintain accounts and records of its financial transactions. Such accounts and records shall explicitly mention, *inter alia*, its financial transactions clearly reflecting the annual condition of its functions and activities, details of every item of income and expenditure, and purchase of goods, as well as detailed particulars of its assets and liabilities.

The accounts of the Board shall be audited by the Auditor General's Department. If the Government of Nepal wishes, it may examine or cause to examine the documents relating to the accounts and records of the Board as well as its cash and kinds at any time.

PENALTIES AND APPEALS

Penalties [Sec. 36]

(1) In case any insurer or director of the insurer, or employee or surveyor or broker or insurance agent willfully violates this Act or the rules framed or orders or directives issued hereunder, or does not perform any function which he is required to perform, or performs any function which is prohibited, the Board may punish such insurer, director, employee, surveyor, agent or broker with fine ranging between Rs. 3,000 to Rs. 10,000. In case the offence is committed again and again, then additional fine of Rs. 500 shall be imposed on him for each subsequent offence.
(2) In case any insurer, insurance agent or broker undertakes insurance business without fulfilling the formalities due under this Act, the Board may punish him with fine not exceeding Rs.10,000.
(3) In case any person willfully or with malafide intension does not maintain, prepare, compile or furnish in time any accounts, particulars, information, or any other documents which he is under obligation to maintain, prepare, compile or furnish under this Act or the rules framed hereunder, or prepares or furnishes false particulars or documents, he may be punished with a fine not exceeding Rs. 30,000 or with imprisonment for a term not exceeding two years or with both.

Any individual or corporate body dissatisfied with the decision made by the Board under this Act may file an appeal with the concerned High Court within 35 days from the date of such decision.

PAYMENT OF INSURNCE CLAIM (AMOUNT) IN THE CASE OF DEATH OF THE INSURER

Procedure of making payment against claims under Life Insurance (Rule 31)

(1) An insurer must issue a discharge voucher in the name of the insured who has already paid the last installment of life insurance premium requesting him to come to collect payments

against the claim along with the insurance policy and other documents required for making payment against a life insurance claim within 15 days from the date of payment of such installment.

(2) In case an insured submits to the insurer the insurance policy and other documents together with the discharge voucher for payment against a life insurance claim under Sub-Rule (1), the insurer shall conduct necessary investigations and make payment against the life insurance claim within seven days from the date of expiry of the term of the insurance policy.

(3) In case any person who has taken up an insurance policy dies before the expiry of the term of his life insurance policy, the person willed by him, if any, and if he has not willed anybody, his legal heir from among the persons mentioned in Sub-Section (1) of Section 38 of the Act, shall submit to the insurer an application for payment against claim explicitly mentioning the following particulars in order to obtain the amount of life insurance:
   (a) Particulars relating to the claim.
   (b) A certificate of death of the insured.
   (c) In case the insured has died in an accident, and in case such risk is covered by the life insurance (policy), the report of post-mortem carried out by a government physician regarding the cause of death, and in case there is no such report, a report of the police.
   (d) A certificate of the relationship with the insured.
   (e) In case the age has not been certified, documents certifying the age.
   (f) Other particulars prescribed by the Board.

(4) On receipt of an application under Sub-rule (3), the insurer shall conduct investigations into the particulars mentioned in the documents submitted in connection with the claims under life insurance, conduct inquiries in respect to other matters also if necessary, determine liability within 15 days from the date of receipt of such documents, and issue a discharge voucher in the name of the applicant requesting him to come to collect payments against the claim. The insurer must make payments again within 15 days from the date of receipt of the discharge voucher from the applicant.

(5) In case it is found in the course of investigations into the particulars under Sub-Rule (4) that the insurance claim need not be paid by determining the liability, the insurer shall inform the applicant, accordingly in writing, explicitly mentioning the reason.

Procedure of making payment for claims under General Insurance (Rule 32)

(1) In case an insured who has taken up a general insurance policy is required to make a claim under the insurance policy, he must submit an application to the insurer explicitly mentioning all the related particulars.

(2) On receipt of an application of an insured for the payment against a claim under general insurance under Sub-Rule (1), the insurer may depute a surveyor immediately to conduct necessary investigations, if necessary.

(3) The surveyor deputed under Sub-Rule (2) shall conduct necessary investigations and determine the liability of the insurer along with the detailed particulars. The insured shall be informed accordingly by mentioning the amount which he may obtain subject to the conditions and facilities of the insurance policy.

(4) The insurer shall determine the liability and make payment against a claim under general insurance to the insured ordinarily within 35 days from the date of submission of the report by the surveyor under Sub- Rule (3).

Payment to be made to Designated Person [Sec. 38]

In case any life insurance policy holder dies before the expiry of the term of his policy, the amount mentioned in such policy shall be paid to the person designated by him therein. In case he has not designated any person, or in case the designee has already died, payment shall be made to the legal heir in accordance with the prevailing law on inheritance.

In case the person designated above dies, or in case the insurance policy holder wants to replace him and writes to the appropriate insurer for designating another person, the insurershall act accordingly and send a written notice thereof to insurance policy holder.

INSPECTION, INVESTIGATION AND SPECIAL AUDIT

Power to Conduct Inquiries and Investigations [Sec. 39]

The Board may make an inquiry or investigation or cause to make an inquiry or investigation as per necessity in the interests of the Insurance Policy Holder or for any other reasonable cause, to any Insurer or Insurance Agent or Surveyor or Broker or Insured as well as including all other related persons or corporate bodies, regarding the Insurance Business and also regarding the other business dealt by any Insurer if it has undertaken any other business.

It shall be the duty of the insurer as well as incumbent or former employees of the insurer, and insurance agents, surveyors, brokers, insured and other concerned individuals or corporate bodies to cooperate by supplying the accounts and records and other documents as well as information sought and give replies to question asked in the course of inquiries orinvestigations. The expenses incurred in conducting inquiries or investigation shall be borne by the concerned insurer.

Special Provisions Concerning Audit of Insurer [Sec. 39A]

In case the insurer fails to submit to the Board its audit report within the time-limit mentioned in Section 25 of the Act, or in case such reports provides appropriate grounds to verify that there have been irregularities in the insurance business, or in case a petition is filed with the Board complaining that there have been irregularities in the accounts and records of the insurance business operated by the insurer, the Board may audit or re-audit the accounts and records of the insurer or make arrangements for doingso.The insurer itself shall fully bear the expenses incurred for having (its accounts and records) audited or re-audited.

CHAPTER- 10

INTERNATIONAL FINANCIAL TRANSACTIONS ACT, 2054 (1998)

1. LICENSE

International Financial Transaction Act, 2054 was promulgated on 15th Magh, 2054. However, the Act came into force on 15th Jestha, 2065. The Objective of the Act as provided in the preamble is as follows:

- To develop Nepal as a center for international financial transactions,
- To foster the economic development of the nation in the context of open, liberal and market oriented economic policies pursued by the country, and the globalization of international financial markets,
- To regulate and manage the financial activities of international financial entities in Nepal.

License Requirement for International Financial Entity

Section 3 provides that an international financial entity interested to carryout international financial transactions shall be required to obtain a license from the Accreditation Committee under this Act.

Section 13 provides that an international financial entity interested to carry out international financial transaction shall, for the purpose of obtaining license to carry out such financial transaction, submit an application to the Accreditation Committee in the format as prescribed along with the prescribed application fee, details and documentations.

The Accreditation Committee may, before issuing a license to any international financial entity under this Act, demand from such entity such information, details and documentations as it may deem necessary in connection with issuing a license for carrying out international financial transactions. It shall be the duty of the concerned international financial entity to furnish forthwith the information, details and documentations so requested by the Accreditation Committee.

If the Accreditation Committee, after the necessary inquiry made into an application submitted as above for obtaining license to carryout international financial transactions, deems it appropriate to grant a license to carryout international financial transactions, it shall issue a license in the prescribed format prescribing necessary terms and conditions. If a license may not be issued, the applicant shall be informed thereof.

A license issued under this Act for carrying out international financial transaction shall be renewed every year. The license renewal fee and other provisions regarding renewal shall be as prescribed.

The following financial entities may only be authorized to obtain licenses to carry out international financial transactions under this Act:

(a) Foreign bank and trust companies,
(b) International insurance and reinsurance companies,
(c) Companies serving as the registered offices for foreign companies,
(d) International holding and investment companies,
(e) Administrative or regional offices established by foreign companies,

(f) International trading companies,
(g) International finance companies,
(h) Foreign real estate holding companies,
(i) Foreign Patent and royalty companies,
(j) Foreign mutual funds,
(k) International leasing companies,
(l) International merchant banks,
(m) Entities such as foreign partnership and trusts established as body corporate,
(n) International sales transaction companies,
(o) Foreign entities to allow nonresident pensions or deferred bonus plans,
(p) International financial companies providing services like stock broker, underwriter, investment advisor, and pension fund advisor.

In order to obtain a license under this Act, a financial entity should have been registered duly in any country outside Nepal and it should have engaged in international financial transactions at least for a period of 3 years.

Government of Nepal may on the recommendation of the Promotion Board and by notification published in Nepal Gazette, make alteration, additions or deletion to the list of financial entities mentioned above.

Activities Prohibited to International Financial Entities

International Financial Entities shall not be allowed to do the following acts:

(a) To purchase any kind of immovable property within Nepal or to keep in their name otherwise,
(b) To carry out any type of international financial transaction with any person resident of Nepal,
(c) To purchase shares or debentures of any company incorporated in the Nepal under the existing laws,
(d) To open an account in any commercial bank of Nepal. However, an account may be opened in any commercial bank with the permission of the Accreditation Committee for the purpose of running the day-to-day administrative business of the office up to such amount as may be fixed by the Accreditation Committee.

Explanation: "Person Resident of Nepal" means any of the following persons:

(a) Nepalese Citizens other than those residing outside the Nepal for more than the prescribed period for the purpose of being engaged in any employment, doing any business or carrying out any other occupation, or for any other purpose,
(b) Non-Nepalese citizens residing in Nepal for more than the prescribed period for purpose of being engaged in any employment, doing any business or carrying out any other occupation,
(c) Any entity which has been registered in Nepal under the existing laws.

Facilities Available to International Financial Entity

There shall not be any restriction of any kind on a license holder entity to bring in foreign currencies as may be required for international financial transactions. No restriction of any kind imposed by the existing laws relating to foreign exchange shall apply in relation to a license holder entity.

A license holder entity may repatriate outside the Nepal the foreign currencies earned by it by carrying out international financial transactions and the foreign currencies brought in by such entity for the purpose of carrying out international financial transactions. However, no property or capital accrued from any illicit or illegal act shall be allowed to be repatriated. The capital or the property of any International Financial Entity shall not be subjected to nationalization.

2. INTERNATIONAL FINANCIAL TRANSACTIONS PROMOTION BOARD

Formation of Promotion Board

Section 9 provides, an International Financial Transactions Promotion Board consisting of the following members shall be formed to promote international financial activities and develop Nepal as a center for international financial transaction:

(a)	Minister or State Minister, Ministry of Finance	Chairman
(b)	Vice-Chairperson, National Planning Commission	Member
(c)	Governor, Nepal Rastra Bank	Member
(d)	Secretary, Ministry of Finance	Member
(e)	Secretary, Ministry of Law, Justice & Parliamentary Affairs	Member
(f)	A person nominated by Government of Nepal from among persons having experience in financial transactions	Member

The tenure of office of the member nominated under point (f) above shall be two years. The Promotion Board may invite national or foreign experts or advisors involved in international financial transactions to participate at its meeting as observers.

An officer level employee of Nepal Rastra Bank designated by the Promotion Board with the consent of the Nepal Rastra Bank shall act as the Secretary of the Promotion Board. The working procedures of the meetings of the Promotion Board shall be as prescribed. The members of the Promotion Board shall be entitled to receive such allowances and benefits as may be prescribed.

The Promotion Board shall have the following functions, duties and powers:

(a) To frame necessary policies for the promotion of international financial transactions,
(b) To cooperate with Government of Nepal in the formulation of necessary laws so as to promote international financial transactions,
(c) To maintain or cause to be maintained coordination among the concerned governmental, non-governmental and international entities in matters of international financial transactions,
(d) To make necessary recommendations to Government of Nepal in respect of exemptions, facilities and concessions to be accorded to international financial entities for the purpose of establishing Nepal as an attractive center for international financial transactions,

(e) To hear appeals filed by any international financial entity against the suspension or revocation of its license by the Accreditation Committee,
(f) To perform such other functions as may be deemed necessary for promoting international financial transactions.

To delegate any or all of its powers under this Act, Rules or Bye-laws made thereunder to any of its member or the Accreditation Committee, as may be required.

3. INTERNATIONAL FINANCIAL TRANSACTIONS ACCREDIATION COMMITTEE

Formation of Accreditation (Implementation) Committee

Section 11 provides, an International Financial Transactions Accreditation Committee consisting of the following members shall be formed for the purpose of granting licenses to international financial entities to carry out international financial transactions, and for the purpose of regulating financial transactions to be carried out by such entities:

(a) Governor, Nepal Rastra Bank	Chairman
(b) Secretary, Ministry of Finance	Member
(c) Secretary, Ministry of Law,Justice and Parliamentary Affairs	Member
(d) One person nominated by Government of Nepal from among CAs	Member
(e) One person nominated by Government of Nepal from among Economists	Member

The Accreditation Committee may invite national or foreign experts or advisors involved in international financial transactions to participate at its meetings as observers. The tenure of office of the members nominated under point (d) and (e) above shall be two years.

An officer level employee of Nepal Rastra Bank as designated by the Accreditation Committee with the consent of the Nepal Rastra Bank shall act as Secretary of the Accreditation Committee. The office of the Accreditation Committee shall be located at the Nepal Rastra Bank.

The working procedures of the meetings of the Accreditation Committee and allowances and benefits of the members of the Committee shall be as prescribed.

The Accreditation Committee shall, apart from the functions, duties and powers set forth elsewhere in this Act, have the following functions, duties and powers:
(a) To monitor and supervise the financial activities of license holder entities as to whether or not their international financial transaction activities are in line with the provisions of this Act or Rules made thereunder, or other prevailing laws relating to international financial transactions,
(b) To make recommendations to the Promotion Board in respect of facilitates to be accorded to international financial entities for the purpose of making Nepal as an attractive center for international financial transactions,
(c) To make recommendations to the Promotion Board in respect of improvements to be made in the existing laws related with international financial transactions for the purpose of carrying out international financial transactions in an effective and well-managed manner,

(d) To inquire as to whether or not a license holder entity is fulfilling the conditions required to be fulfilled under the provisions of this Act and to require it to fulfill them if they are found not to have been fulfilled,
(e) To give necessary instructions to license holder entities in respect of international financial transactions.
(f) To avail itself of the service of national or foreign experts or specialized agencies for the promotion and development of international financial 8 transactions,
(g) To comply with the instructions given from time to time by the Promotion Board,
(h) To suspend or revoke, as may be required, the license obtained by any license holder entity in cases where it is in violation of the provisions of this Act or Rules made thereunder, or the existing laws relating to international financial transactions. However, such an entity shall be given an opportunity to submit its explanation before such revocation.
(i) To perform such other acts, as may be prescribed, for making international financial transactions effective.
(j) To delegate any or all of its powers under this Act, Rules or Bye-laws made thereunder to any of its member, a sub-committee or an employee of officer rank, as may be required. However, the Accreditation Committee shall not be entitled delegate its power of issuing license for carrying out international financial transactions or of revoking or suspending it.

Confidentiality

The Accreditation Committee shall maintain secrecy of all documents and information which are related with license holder entities and are in possession or control of the Accreditation Committee.

The Accreditation Committee shall not be compelled to produce such documents or information before any court, commission of inquiry, Commission for the Investigation of Abuse of Authority or committee of inquiry, nor shall it be compelled to leak otherwise the secrecy of such documents or information.

However, if there are sufficient grounds to prove that the documents or information related to the international financial transaction carried out by a license holder entity are connected with illicit narcotic drugs or illegal arms and ammunition, the court may, on the request of the prosecuting authority acting on behalf of Government of Nepal, give an order to have such documents and information produced before it.

CHAPTER- 11

COOPERATIVES ACT, 2074 (2017)

1. INTRODUCTION

Nepal has a long cultural tradition of informal community based cooperatives including savings and credit associations popularly known as 'Dhikuti' and 'grain savings' and 'Labour exchanging' systems known as 'Parma' and 'Dharma Bhakari'. Similarly, Guthi provided a forum to work together for smoothly running different socio-cultural practices. Many of these traditional systems of cooperation are still functioning in the rural areas of Nepal.

The first Cooperative Act was enacted by the government in 1960, which was followed by the Agricultural Cooperative Act (SajhaSahakari). In 1963, the capital of savings and credit cooperative societies was converted into a Cooperative Bank in 1963, and in 1968 it was also converted into the Agricultural Development Bank of Nepal (ADBN). After 5 years the Agricultural Development Bank of Nepal returned management back to the government and in 1975 the Cooperative Act was amended again.

Beginning in the 1980s a new generation of community based savings and credit groups began to emerge in Nepal. The Cooperative Act was amended for the third time to give the Government more control. By this time the Savings and Credit movement had spread throughout the country and the need for an apex coordinating body was evident. In August 16, 1988, the Nepal Federation of Savings and Credit Cooperative Unions (NEFSCUN) was formed.

After people's movement the new democratic government enacted the Cooperative Act and the Cooperative Regulations in 1992 and 1993 which permitted the establishment of a three tiered cooperative system, and provides a legal base both for the establishment of cooperative societies/unions/federations and application of cooperative values, norms and principles into practice.

Nepalese Cooperative movement has seen a lot of socio-economic as well as political changes. In 2008, Nepal was declared as a Federal Democratic Republic of Nepal. In 2015, constitutional assembly successfully declared the new Constitution of Nepal which recognized the cooperative sector as one of the three pillars of the National Economy. In 2017 and 2018 new Cooperative Act and Regulation were enacted. The new constitution has decentralized and delegated the authority to the Local and Provincial governments to promulgate the laws and act that they need. Now provincial government and local level government bodies can promulgate and implement the cooperative law.

According to the Department of Cooperative the major types of cooperative societies operating in Nepal are saving and credit, multipurpose, dairy, agriculture, fruits and vegetables, bee keeping, tea, coffee, consumers, science and technology and energy. It is believed that around 6 million people are the members of 34,512 cooperatives and more than 60,517 people are employed directly in Cooperative business.

The Cooperatives Act, 2074 was promulgated on 2074/4/1 Government of Nepal has formulated Cooperative Rules, 2075 by virtue of the powers conferred by section 149 of the Cooperative Act, 2074. The Objectives of the Act as laid down in the preamble are as follows:

- To integrate the capital, technology and talents scattered amongst farmers, laborers, craftsperson, low income groups or backward/marginalized communities or general consumers according to cooperatives norms, values and principles,
- To promote economic, social and cultural development of members,
- To promote the regulation of Cooperative Society as community based, member centric, democratic, autonomous, corporate entity,
- To develop self-reliant, sustainable and socialism oriented national economy by way of cooperative farming, industries, goods and services enterprises,
- To amend and consolidate existing laws on cooperatives, thereby making it time bound.

In this Act, following terminologies are used as follows [Sec. 2]:

(a) Ministry:"Ministry" means Ministry of Government of Nepal looking over cooperative affairs.

(b) Department: "Department" means Department of Cooperatives.

(c) Cooperative Society:"Cooperative Society" means a Society or Unionand the word includes a Cooperatives Bank as well.

(d) Union:"Union" means the District Sectoral Cooperative Union, District Cooperative Union, Province Sectoral Cooperative Union, Province Cooperative Union, Central Sectoral Cooperative Union and Specialized Cooperative Union registered pursuant to Section 15 and the word also includes the National Cooperative Federation formed under the same Section.

(e) Society: "Society" means a Sectoral or Multipurpose Society formed pursuant to section 3 and registered pursuant to section 15.

Cooperative Society to be Corporate Body [Sec. 17]

After the incorporation of the Cooperative **Society**, it shall be a corporate body with the following characteristics:

- Cooperative Society shall be an autonomous corporate body having perpetual succession.
- There shall be a separate seal for carrying out functions and activities of Cooperative Society.
- Cooperative Society may, subject to this Act, acquire, utilize, sell or dispose of movable or immovable property as a person.
- Cooperative Society may sue a case as a person and it may be sued against in its name.
- Cooperative Society may conclude a contract as a person.

Liability of a member in terms of transaction of a Cooperative Society shall be limited only up to the maximum limit of the shares he/she has subscribed or agreed to subscribe. The name of a Cooperative Society shall contain "cooperative" and it shall contain the word "limited" at the end [Sec. 22].

Registration of Cooperative Society

Section 13 provides, no one shall operate Cooperative Society without registration under this Act. Cooperative Societies in operation during the commencement of this Act shall be deemed to have been registered under this Act.

Section 14 has provided provisions relating to application for the registration of Cooperative Society. Cooperative Society formed under this Act shall submit an application to their following respective authority in the prescribed format for registration.

The respective authorities are as follows:

- To the Authority authorized by the Registrar: In case of Societies, District Sectoral CooperativeUnion or District Cooperative Union:
- To the Registrar: In case of Provincial Sectoral Cooperative Union, Provincial Cooperative Union, Central Sectoral Cooperative Union, Specialized Cooperative Union, National Cooperative Federationor Cooperative Bank

The application shall be submitted along with the following documents:

- Byelaws of the proposed Cooperative Society,
- Feasibility study report of Cooperative Society operation,
- Details of number of shares and share amount accepted by member,
- Prior approval letter of Nepal Rastra Bank in case of registration of Cooperative Bank,
- Other details as prescribed

Section 15(1) provides, the Registrar or the authority authorized by the Registrar shall register the Cooperative Society within 30 days of receipt of application and provide certificate in the prescribed format if the following conditions are satisfied:

- The byelaws submitted with the application is as per this Act and Rules framed under this Act,
- There is the basis for operation of proposed Cooperative Society as per cooperative values, beliefs, and principles,
- There is clear basis that the Cooperative Society could be run and controlled being community-based and member-centric,
- Fulfillment of other bases as prescribed.

If it is deemed necessary that the Cooperative Society cannot be registered without amending its byelaws, the Registrar or authority authorized by the Registrar shall provide notice by clarifying such details within 15 days of the date of receipt of the application.

While registering Cooperative Society as per this section, the Registrar or the concerned authority may prescribe terms to be complied by the cooperativesociety. It shall be the duty of the Cooperative Society to comply with the prescribed terms.

If situation as per section 15(1) does not exist or if the applicant has refused to amend the byelaws as per notice provided as per the same section or if the byelaws has not been amended or has not been amended as per the provided notice within 30 days of receiving such notice, the

Registrar or the Authority authorized by the Registrar may refuse to register such Cooperative Society. The Registrar or Authority authorized by the Registrar shall provide written information of the refusal of registration by clarifying the reason within 3 days to the concerned applicant.

Formation of the Cooperative Society

Section 3 provides, at least thirty Nepali citizens may mutually form a sectoral or multipurpose Cooperative Society. However, in case of a Cooperative Society carrying business based on labor and skills involving laborers and youths and others, even 15 Nepali citizens may form such society.

Participation of at least one hundred Nepali citizens shall be required while forming a society carrying transactions of savings and credits in a Metropolitan City or Sub-Metropolitan City.

While forming a society under this section, the number referred as above, shall include at the rate of one member per family. However, there shall be no hindrance to acquire membership by more than one person of a family once a society is registered pursuant to Section 15.

Notwithstanding anything contained elsewhere in this section, at least 100 employees, teachers or professors who are incumbent in an office receiving remuneration from Government of Nepal, Provincial Government, Local Level or from a school, University or corporate entity getting a grant from, or under the ownership of such government or level may, at mutual cooperation, based on the professional organization formed according to the prevailing law, form a society under membership, representation and service operation with a conditiontoabidebythetermsandconditionsasprescribed.. However, in case of office having less than 100 number of employees, society may be formed by at least 30 employees, teachers or professors with a condition to abide by the terms and conditions as prescribed.

Formation of District Sectoral Cooperative Union

Section 4 provides, at least 11 societies registered pursuant to section 15 for carrying out works including works of development, promotion and marketing of Cooperative business may together form a District Sectoral Cooperative Union on their specific sector. However, at least 6 societies may together form a district Sectoral Cooperative Union on their specific sector in the remote districts which Government of Nepal has specified as those belonging to Class "A".

Formation of District Cooperative Union

Section 5 provides, at least 15 societies or District Sectoral Cooperative Unions may mutually from a District Cooperative Union in order to contribute in function such as the development, promotion and marketization of cooperative business.However, in rural district prescribed as "A" category by the Government of Nepal, at least 7 societies may mutually form a District Cooperative Union. While forming the Union in such a manner, it shall include in the Union more than 50 % of the District Sectoral Cooperative Unions registered in the district.

Formation of Provincial Sectoral Cooperative Union

Section 6 provides, at least 25 Sectoral Cooperative Societies or District Sectoral Cooperative Unionsof at least 5 districts registered pursuant to section 15 for carrying out works including works of development, promotion and marketing of Cooperative enterprise may together form a Provincial Sectoral Cooperative Union on their specific sector. However, while forming Union in such a manner, it shall include in the Union more than 50 % of the District Sectoral Cooperative Unions registered in the Province.

Formation of Provincial Cooperative Union

Section 7 provides, at least 31 societies formed in at least five districts or District Sectoral Cooperative Unions or District Cooperative Unions or Provincial Sectoral Cooperative Unions may together form Provincial Cooperative Union in order to support in development, promotion and marketing of cooperative enterprises. However, while forming the Union in such a manner, more than fifty percent of each of the District Sectoral Cooperative Unions, District Cooperative Unions or Provincial Sectoral Cooperative Unions registered all over the province shall have to be included.

Formation of Central Sectoral Cooperative Union

Section 8 provides, at least 51 Societiesformed in at least 7 districts or District Sectoral CooperativeUnion or Provincial Sectoral Cooperative Unions may together form Central Sectoral Cooperative Union in order to support in development, promotion and marketing of cooperative enterprises.However, while forming the Union in such a manner, more than 50 % of each of the District Sectoral Cooperative Unions or Provincial Sectoral Cooperative Union shall have to be included.

Formation of Specialized Cooperative Union

Section 9 provides, at least 25 multi-purpose or Sectoralsocieties registered pursuant to section 15 may togetherform a Specialized Cooperative Union for carrying out works requiring large amount of investment relating to hydro power, chemical fertilizers factory, residential projects, transport, heavy agro equipment, fruits processing, herbs processing, sugar industries, cold storage, hospital, college, technical schools, laboratory or to fulfill the demand of common needs of members.

Such Union shall be entirely business organization. This shall not have right to choose or to be chosen in any Union or Federation. Its operational procedures shall be as prescribed.

Formation of National CooperativeFedearation

Section 10 provides, the following societies or unions may collectively form National Cooperative Federation to perform function such as promoting or making to promote good governance in the field of cooperative on the basis of cooperative values, practices and principles:

- More than 50% of District Sectoral Cooperatives Unions formed under section 4.
- More than 50% of District Cooperatives Unions formed under section 5.
- More than 50% of Provincial Sectoral Cooperatives Union formed under section 6.

- More than 50 % of Provincial Cooperatives Union formed under section 7.
- More than 50 % of Central Sectoral Cooperatives Union formed under section 8.

The National Cooperative Federation registered at the time of commencement of this Act shall be deemed to have been converted as the National Cooperative Federation under this Act.

More Than One Unions Not to be Formed

Section 11 provides, notwithstanding anything mentioned in section 4, 5, 6, 7, 8, and 10 more than one District Sectoral Cooperatives Union or District Cooperative Union in a single district of the same nature or more than one Provincial Sectoral Cooperative Union or Provincial Cooperative Union in a single Province of the same nature or more than one Central Sectoral Cooperative Union in the Central level of the same nature or more than one National Cooperative Federation in national level shall not be formed.

Jurisdiction of Cooperative Society

Section 18 provides, the working areas of a Cooperative Society at the time of registration shall be as follows:

(a) In case of a society carrying out main transaction of savings and credits in Metropolitan City or Sub-metropolitan City, one ward,
(b) In case of a society carrying out the main transaction of savings and credits and in case of other societies in a Municipality or Rural Municipality, in one Local Level only on the following basis as prescribed:
    (i) Common bond executed for mutual practice of self-reliance among members,
    (ii) Number of the members required for operating services in commercial manner,
    (iii) Convenient place for having participatory democratic control of members in operation of the Organization.

Society may after 2 years of operation after registration extend jurisdiction on the following basis in a geographic area attached to it:

(a) There is a need to extend jurisdiction in order to increase membership for the development process of society's business activities,
(b) Application of creative solution to maintain direct control of society's work operations,
(c) There is no contrary to the standards determined pursuant section 15(6).

Notwithstanding anything contained elsewhere in this section, the working areas of a societymay be extended to one local level or district or more than one districts or more than one province during the time of registration, which requires wider working areas due to expansion of commercial areas such as hydropower project, education, linguistic (language), literary cultural, health services, communication, production, storage and processing special agro or forests products or increase of participation of members.

Notwithstanding anything contained in this section, Cooperative Society may at any time voluntarily re-determine its jurisdiction so as to decrease it by amending its byelaws.

Section 19 provides, the jurisdiction of Unions and Cooperative Bank shall be as follows:

(a) One district in case of District Sectoral Cooperative Union or District Cooperative Union,
(b) One province in case of Province Sectoral Cooperative Union or Province Cooperative Union,
(c) Throughout Nepal in case of Central Sectoral Cooperative Union or National Federation of Cooperatives,
(d) In case of a specialized union, depending upon collection, distribution or flow of service based on its nature,
(e) In case of a Cooperative Bank, as specified by the Nepal Rastra Bank.

Operation of Transactions, Business, Industry or Project

After receiving the certificate of registration, the society or union may operate necessary transaction, business, industries, or project subject to this Act and Byelaws for the purpose of attainment of its objectives. The Cooperative Bank may operate its transaction or services only after obtaining license from the Nepal Rastra Bank.

Notwithstanding anything contained in the prevailing laws, the society or union does not need to register an organization separately in order to carry on transaction, business, industries, or project. However, in case the prevailing law requires such permission, approval or license has to be obtained to carry on such transaction, business, industries, or project, such transaction, business, industries, or project shall be carried out only after obtaining the permission, approval or license, accordingly. In case the society or union obtains permission, approval or license from the agency or authority authorized according to the prevailing laws, it shall inform the Registrar or the authority authorized by the Registrar within fifteen days of the date of receipt of such permission, approval or license.

Two or more unions and unions may, subject to this Act, carry on transaction, business, industries, or project for marketing of their product or service jointly or in partnership.

Notwithstanding anything contained in the prevailing laws, thesociety or union may sell the product of the transaction, business, industries, or project to be operated by it in the brand name of the Cooperative. However, in case the prevailing law requires that the approval of receiving such brand has to be obtained, such approval shall be obtained accordingly.

Exemptions, Facilities and Concessions Available to Cooperative Society

Notwithstanding anything contained in the prevailing laws, Cooperative Society shall be provided with the following exemptions, facilities and concessions:

- Cooperative Society shall not be required to register any transactions other than those of immovable assets.
- Cooperative Society shall not be charged revenue stamp or registration fee while purchasing land and building or other immovable assets for the purpose of its office or service center. However, it shall be applicable while purchasing land or other immovable assets for business purpose. Where land or other immovable assets purchased by availing exemption of such fees is sold, such exempted fees shall be refunded.
- No charge shall be levied on mortgage of land taken as collateral in providing loans.

Notwithstanding anything contained in the prevailing laws, income tax shall not be levied in amount deposited in Reserve Fund, Patronage Capital Redemption Fund and Cooperative Promotion Fund. However, members shall be taxed as per prevailing laws while receiving payment from the Patronage Capital Redemption Fund.

Government of Nepal may by publishing notice in the Nepal Gazette provide exemption of custom duty or VAT in the import of machinery, industrial or agricultural machinery or equipment, parts, raw materials or transportation vehicles for the use of Cooperative Society.

Government of Nepal may by publishing notice in the Nepal Gazette provide full or partial exemption of excise duty or VAT in the goods produced by Cooperative Society.

Government of Nepal may by publishing notice in the Nepal Gazette provide exemption of export tax and provide export cash grant as provided to other industries on export of goods produced by the Cooperative Society.

In addition to the exemptions referred to in this section, the Cooperative Society carrying out industrial enterprises shall be provided with the exemption, facilities and protection according to the prevailing laws which an industry is being provided and the Cooperative Society carrying construction and operation of infrastructure structures, or carrying out special industries, enterprises, or services shall be provided with those facilities as are being provided to such industry, enterprise and service.

Government of Nepal, Provincial Government or Local Level may grant partial or full exemption in any type of tax to be imposed according to the prevailing law or make available special financial facilities or technical support for promotion of cooperative farming by deprived rural women, persons with disability, freed kamaiyas, freed haliyas, landless farmers, unemployed laborers, dalits and minority communities of marginalized groups or self-employment enterprises based on labor or skills of members.

In case laborers desires to bring into Cooperative any sick public or private industry and to operate it again on their ownership, Government of Nepal may, considering the nature of the industry, provide grant for seed capital, loan or transfer of the ownership with discounted loan or provide tax exemption in transfer of private ownership, or provide guarantee or other appropriate assistance.

Objectives and Functions of Society or Union

The main objective of a society or organization shall be to attain economic, social and cultural prosperity based on working areas and on being concentrated on its members. The society or union shall carry out the following functions:

- To comply with or cause to be complied with the values, norms and principles of cooperatives,
- To promote interests of members and its own and to carry out or cause to be carried out their marketing,

- To provide education, training and information to members and to pro-mote or cause to be promoted good governance in society or union,
- To promote or cause to be promoted mutual cooperation between society and union,
- To determine standards of the products and services of the society or union and to carry out functions as to quality reform, economic stability and risks management,
- To submit internal control system,
- To operate activities relating to commercial promotion and development of society or union,
- To comply with the directives of the Ministry, Registrar, Province, local level or office,
- To carry out functions referred to in the Byelaws.

Functions of National Cooperative Federation

National Cooperative Federation shall perform the following functions for the promotion of interests of its members:

- To comply with or cause to be complied with the values, norms and principles of cooperatives,
- To play leading roles for promotion of interests of members,
- To carry out coordination and collaboration with various agencies of Government of Nepal on promotion of cooperative sector,
- To conduct and cause to be conducted commercial and market-related studies and researches for promotion of cooperative enterprises,
- To provide or cause to be provided education, trainings, and information,
- To develop market information system,
- To promote or cause to be promote mutual cooperation among societies and unions,
- To promote mutual cooperation in international cooperatives movement and to coordinate and expand relations,
- To promote good governance in cooperative sector,

To carry out such other functions as referred to in the Byelaws.

2. MEMBERSHIP

Membership of Society

Section 30 provides, the following Nepali citizens having completed the age of 16 years may become members of an Organization:

- Residing within the working area of the society,
- Having subscribed at least one share of the society,
- Having agreed to comply with the terms and conditions referred to in Byelaws of the society,
- Having agreed to bear responsibility of the society,
- Not having transactions that is competitive with the transactions being carried out by the society.

Notwithstanding anything mentioned elsewhere in this Act, there shall not be restriction for entities of Government of Nepal, Provincial Government, Local level, cooperative school and community schools, trusts, local clubs within the working area of the society, non-profit

motive organizations, production &service-oriented organizations and associations, consumers groups formed at local level to become a member of the Society. Notwithstanding anything contained else where in this section, there shall not be restriction for Cooperative society to become a member of the health cooperative society.

Person desiring to obtain membership of society shall make an application to the Board of the society. The Board shall make decision as per the Act, Rules, and byelaws whether to provide or not to provide membership within 35 days of receiving of application. If decision is made not to provide membership, information shall be provided to the applicant within 7 days stating the reason/s.

Person receiving notice of refusal of registration of the Cooperative Society as above, may make an appeal to the authority authorized by the Registrar within 30 days of receiving such notice. If upon investigation of appeal, it is observed that the applicant shall be provided membership of the society, the authority may issue order to the society to provide membership to the applicant. If order is received, the concerned society shall provide membership to the applicant and provide information to the authority authorized by the Registrar within 7 days of the receipt of the order.

To be Members

Section 33 provides membership of Societies, District CooperativeUnions, District Sectoral Cooperative Unions, Province Sectoral Cooperative Union, Province Cooperative union, Central Sectoral Cooperative Union, National Cooperative Federation and Cooperative Bank as follows:

- The Sectoral societies within a district may become member of the District Sectoral Cooperative Union referred to in section 4
- The Sectoral Societiesand District Sectoral Unions in the district may be become member of the District Cooperative Union referred to in section 5.
- The Sectoral Societiesand District Sectoral Unionss in the province may be become members of the Province Sectoral Cooperative Union referred to in section 6.
- Societiese, District Sectoral Cooperative Unions, District Cooperative Unions and Province Sectoral Cooperative Unions in the Province may become members of the Province Cooperative Union.
- Sectoral societies, District Sectoral Unions and Province Sectoral Unions may become members of the Central Sectoral Cooperative Union referred to in section 8.
- District Sectoral Unions, District Cooperative Unions, Province Sectoral Unions, Province Cooperative Unions and Central Sectoral Cooperative 'Union may become members of the National Cooperative Federation referred to in section 10.
- Only Societies and Unions may become members of the Cooperatives Bank.
- The process of acquiring membership under this section shall be as prescribed.

Termination of Membership

Membership of any member shall be terminated in the following circumstances:

- In case a member withdraws its membership,
- In case a member is absent in the annual General Meeting for a consecutive three times without a notice,

- In case a member frequently violates the provisions it has to comply with according to this Act, Rules or Byelaws framed under this Act,
- In case of a member, who does not have qualifications referred to in section 30.

Notwithstanding anything mentioned above, in case any member has any amount received from, or to be repaid to, a Cooperative Society, the membership shall not be terminated until such an amount is settled; or if such a member has obtained any credit or has any liability to be met or has pledged collateral or guaranteed on behalf of any other member, the membership shall not be terminated until such liability is absolved.

If a decision to call general meeting has been made, no member shall be removed before the completion of the general meeting.

3. GENERAL MEETING, BOARD OF DIRECTORS & ACCOUNT SUPERVISION COMMITTEE

General Meeting

Section 36 provides, there shall be a General Meeting as the supreme body of a Cooperative Society. All the members of the Cooperative Society shall be the member of general meeting. General meetings of the Cooperative Society shall be as follows:

- Preliminary General Meeting,
- Annual General Meeting,
- Extraordinary General Meeting.

The quorum of General Meeting of Cooperative Society shall be at least 51% of total members of the society. If the required quorum is not met, the meeting shall be adjourned and next meeting shall be called within 7 days. The quorum of the adjourned meeting shall be deemed to have satisfied if it is attended by one-third of the members and majority of board of directors (BOD).

Cooperative Society having 2,000 or more members may perform GM by sending members of Board of Director at local level or a ward thereof and may appoint representatives to authenticate the decisions and final decision shall be authenticated by a meeting on the presence of such representatives.

The Board shall call preliminary General Meeting within 3 months of registration of Cooperative Society. The functions, duties and powers of preliminary general meeting shall be as follows:

- To get information of actions taken and financial transactions made until the day preceding to the holding of the preliminary General Meeting,
- To approve annual program and budget for the current fiscal year,
- To approve reports and financial statements,
- To elect Board and Account Supervision Committee as specified in the Byelaws,
- To adopt internal procedures,

- To appoint Auditor and determine his or her remuneration,
- To carry out such other functions as referred to in the Byelaws.

The Board shall call Annual General Meeting within six months from the completion of each fiscal year. The functions, duties and powers of Annual General Meeting shall be as follows:

- To approve annual program and budget,
- To approve annual audit report,
- To elect and dissolve the Board of Directors and Account Supervision Committee,
- To remove from the office of a director, convener or member of the Account Supervision Committee,
- To adopt the annual report of the Board of Directors or of the Account Supervision Committee,
- To adopt Byelaws and internal procedures,
- To appoint Auditor and determine his or her remuneration,
- To take a decision as to unification or dissolution of the Organization,
- To determine incentive including remuneration,
- To accept external liabilities,
- To write off liability of a member,
- To issue necessary directives to the Board of Directors,
- To carry out such other functions as referred to in the Byelaws.

The Board shall call an Extra ordinary General Meeting in any of the following circumstances:

- On the recommendation of account supervision committee pursuant to section 49(1)(f),
- If Board accepts the request to hold Extra ordinary General Meeting submitted by any director,
- Board decides to call Extra ordinary General Meeting for any special reason,
- If 15% of the members of the society submit application along with reason/s to the Board to hold Extra ordinary General Meeting.
- If direction is given by Registrar or Authority authorized by the Registrar pursuant to section 40(1).
- If order is issued by Registrar or Authority authorized by the Registrar pursuant to section 42(2).

Power of Registrar to Give Direction to Call Extra ordinary General Meeting

Registrar or authority authorized by the Registrar may direct the Cooperative Society to call an Extra ordinary General Meeting in case any of the following circumstances is found while carrying out inspection or supervision of any Cooperative Society or while inquiring into a complaint:

- Performed work in violation of cooperative values practice and principles,
- Performed work in violation of this Act, Rules, byelaws as well as internal procedures,

- Observation of serious comments on NRB inspection and supervision in case of Cooperative Bank,
- Frequent violation of direction issued by Registrar or authority authorized by the Registrar,
- Order issued by Registrar or officer authorized by the registrar pursuant to section 42(2).

The Board shall call Extra ordinary General Meeting within 35 days from the date of receiving direction of the Registrar or authority authorized by the Registrar. The matters relating to complaint and observed during the supervision shall be discussed in the Extra ordinary General Meeting and report shall be submitted to the Registrar or the authority authorized by the Registrar.

If the Board fails to call the Extra ordinary General Meeting within the time prescribed as above, the Registrar or the authority authorized by the Registrar shall call Extra ordinary General Meeting.

Board of Directors

Section 41 provides, there shall be a Board of Directors in a Cooperative Society elected by the General Meeting. The Board shall, to the extent availability of female members, ensure the representation of at least 33 % women members. No more than one person of the same family may become a candidate and be elected at the same tenure as a director and a member of the Account Supervision Committee.

Director of any Cooperative Society shall not be entitled to become employee of the same society or director of any Cooperative Society in which the Organization has not acquired membership. However, there shall not be any restriction for any director to work as an employee of the Cooperative Society with annual turnover of less than 2 crore. If any director is working as an employee in the Cooperative Society with turnover exceeding 2 crore, he/she shall surrender the post of employee within 4 years from the date of commencement of this Act and make arrangement for another employee.

It further provides that a person may become a Director of only one Cooperative Society at a time. The Act has provided cut-off period to a person who is director in more than one Cooperative Society or employee of same or other Cooperative Society before the commencement of this Act. Such person shall be required to become director or employee of only one Cooperative Society within 1 year from the date of commencement of this Act.

The tenure of Board of Directors of Society or Union or Federation or Cooperative Bank shall be 4 years. In addition to other functions, duties and powers mentioned in the Act, the functions, duties and powers of the Board shall be as follows:

- To operate the Cooperative Society according to norms, values and principles of Cooperatives,
- To carry out or cause to be carried out financial and administrative functions,
- To call preliminary General Meeting, annual General Meeting, extraordinary General Meeting,

- To implement or cause to be implemented the resolutions of the General Meeting,
- To prepare policies, plans, budget and annual programs of the Cooperative Society and to submit them to the General Meeting,
- To grant membership of the Cooperative Society and to remove from membership,
- To carry out functions relating to share transfer and withdrawal,
- To acquire membership of the concerned union,
- To frame Byelaws and internal procedures and to submit them in the General Meeting,
- To carry out or cause to be carried out necessary functions for promotion of transactions and commercial interests subject to the working areas of the Cooperative Society,
- To carry out such hold other functions as prescribed.

Election of Board

The Board shall have to conduct the election of another Board before the expiry of its term of the office. In case information is received that the election of the Board is not held, Registrar or authority authorized by the Registrar may order the concerned Board to complete the election within six months from the date of receipt of such information. The Board shall hold election of the Board within the provided time and provide information to the Registrar or the authority authorized by the Registrar.

In case the election is not held as above, the Registrar or authority authorized by the Registrar shall carry out entire actions relating to election of the Board having involved representative of the higher union if any of such society in which it is a member. It shall be the duty of the concerned union and the Board to render assistance in the election. All expenses for holding the election as such shall be borne by concerned Cooperative Society.

A director shall not continue in his/her position in any of the following situations/conditions:

- In case the resignation tendered by him or her is accepted by the Board,
- In case a decision is taken to remove him or her from the office of Director pursuant to sub-section (1) of section 45,
- In case he/she is director of another Cooperative Society as well,
- In case he/she is an incumbent employee in the same society or another society,
- In case he/she is a member of the Account Supervision Committee in the same society or another society,
- In case he/she dies.

Removal of Director

The General Meeting may remove any director from the board of directors by the decision of majority of members present in the general meeting in any of the following situation:

- Financial misappropriation causing loss to the concerned Society,
- Violation of confidential information of the transactions of the concerned Cooperative Society in an unofficial manner,

- Involving in the same nature of business or transaction of the concerned Cooperative Society in a competitive manner,
- Performing any action against the interest of the concerned Cooperative Society,
- Unable to perform function physically or mentally,
- If any director does not possess qualification provided in this Act, Rules framed under this Act or bye-rule.

Before removing any director, the concerned director shall be provided opportunity of hearing in the General Meeting. The General Meeting may remove such director if he/she does not submit clarification or the submitted clarification is not satisfactory. The member removed from the director as such shall not be eligible to become a candidate for a period of two terms of the office.

In case any director is removed from the office, the General Meeting shall elect another person as the director for the remaining term of the office.

Dissolution of Board

The General Meeting may dissolve the Board and elect a new Board in the following conditions/circumstances:

- In case transactions of the Cooperative Society are at risks due to malafide acts of the Board,
- In case of failure to pay the liabilities to be paid by the Cooperative Society within the specified time,
- In case of commission of an act against the objective and business specified in the Byelaws,
- In case the Board does not fulfill its responsibilities,
- In case of frequent violation of this Act or conditions referred to in Rules or the directives issued by the Registrar or the authority authorized by the Registrar.

In case the Board does not comply with the directive issued by the Registrar or the authority authorized by the Registrar under this Act or Rules framed under this Act or on the basis of gravity of the subject matter found in the complaint filed or found in the course of inspection according to the report submitted pursuant to section 40(2), the Registrar or Office in-charge may give a time of six months for reform. If no reform is taken place even within that period, such a Board shall be dissolved.

In case the Board is dissolved by the Registrar or the authority authorized by the Registrar, he/she shall have to form an adhoccommitte as prescribed for holding election of another Board within three months from the date of dissolution and to operate the daily transactions of the Cooperative Society until the election is held. All expenses related to electing new Board shall be borne by the concerned Cooperative Society.

It further emphasizes that while dissolving the Board of a Cooperative Bank, advice of Nepal Rastra Bank shall be obtained and action shall be carried out as per such advice.

Account Supervision Committee

Section 48 provides, in order to strengthen the internal control system in a Cooperative Society, the General Meeting shall form through election an Account Supervision Committee comprising of one convenor and two members having met the prescribed qualifications. More than one member of the same family shall not stand as candidate or get elected at the same tenure as a director or convener or member of the Account Supervision Committee of the same Cooperative Society. The convenor and members of the Account Supervision Committee shall not be involved in daily and administrative functions of the Cooperative Society.

The functions, duties and powers of the Accounts Supervision Committee shall be as follows:

- To conduct or cause to be conducted internal auditing of the Cooperative Society in every four months,
- To comply with or cause to be complied with the basic principles of auditing while conducting internal auditing,
- To inspect and evaluate and cause to be inspected or evaluated financial transactions,
- To have regular supervision of the actions and activities of the Board and to provide necessary suggestions to the Board,
- To monitor whether or not directives issued or decisions made by the General Meeting and decision of the Board have been implemented,
- To submit to the General Meeting accounts report and annual report on supervision of the functions of the Board,
- To recommend the Board to call the extraordinary General Meeting showing the reasons thereof that adverse impact is caused in the interests of any Cooperative Society due to noncompliance of the recommendations made by it frequently; that there have been embezzlement or massive misuse of cash or kind assets of such organization or in case the organization is likely to undergo serious financial crises,

To make recommendation of names of three persons to be appointed as internal auditor, if required.

4. MOBILIZATION OF SAVINGS, CREDIT AND FINANCIAL RESOURCES

Savings and Credit Transactions to be Member Focused

Section 50 provides, a Cooperative Society may accept savings only from its members, mobilize such savings and disperse credits only to the members.

No sectoral or multi-purpose society, other than the society registered with the main objective of making transactions of savings and credit, shall be allowed to make savings and credit transaction as the main transaction. However, in case any sectoral or multi-purpose society has been carrying out the main objective of making transactions of savings and credit at the commencement of this Act, such a society shall, within a period of three years, make provisions of not carrying out the transaction of savings and credits as the main transaction and to have the main transaction of the matter which was stated at the time of registration of the society.

Except otherwise specified by the Registrar, service charge and renewal fee on credits disbursed by Cooperative Society to members shall be as stated in the procedures of the concerned society. The difference of the rate of interests on savings and on credits (spread) shall not be more than six percent. The interest to be charged on credit disbursed by a Cooperative Society shall not be charged having capitalized the interest in the main credit amount.

A Cooperative Society shall not use the savings amount in the purchase of immovable assets, infrastructure construction, and investment in transactions, firms and company or in share of any bank or in any other purpose except in credit investment among members, in the bonds issued by Government of Nepal, Cooperative Bank or share of Sana Kisan Laghubitta Sanstha.

Cooperative Society may accept deposit up to 15 times of its primary capital fund. A society or union may not make credit investment to members, other than the members who are listed at the time of registration, until a period of three months is completed after acquiring the membership.

Reference Interest Rate

The Registrar shall on the recommendation of the following committee prescribe reference interest rate (directive interest rate) for the purpose of Cooperatives Organization in the context of savings and credit:

(a)	Registrar	Coordinator
(b)	Representative, Ministry	Member
(c)	Representative, Ministry of Finance	Member
(d)	Representative, Nepal Rastra Bank	Member
(e)	Representative, National Cooperative Development Board	Member
(f)	Chairperson, National Cooperative Federation or Director Representative designated by him/her	Member
(g)	Representative, National Cooperative Bank	Member
(h)	Chairperson of Federation or a director designated by him/her and two persons from Central Sectoral Unions	Member
(i)	Deputy Registrar, Department of Cooperative	MemberSecretary

Sales and Withdrawal of Shares

"Share" means a divided portion of the share capital of a Cooperative Society. The membership of a Cooperative Society is represented by shares. The Cooperative Society may sale shares to its members. In selling its shares, a Cooperative Society shall so sell shares to a member that it does not exceed twenty percent of its total share capital to a single member. However, this restriction shall not apply to an organization or body fully or partially owned or controlled by Government of Nepal. A Cooperative Bank may sell its shares to institution or entity fully or partly owned or controlled by Government of Nepal in addition to its members.

Face value of share of Cooperative Society shall be Rs. 100 and the share capital shall be as prescribed in the byelaws. Cooperative Society shall not sell shares in the open market. The share of any member remaining as the principal amount of any Cooperative Society shall not be

sold by auction for any loan or liability, other than the loan or liability of the same Cooperative Society.

If any member surrenders his/her membership and wishes for refund of amount, his/her amount shall be refunded after deducting his her liability if any within 3 months of payment of liability. If any member asks for refund of savings deposited in the Cooperative Society, his/her saving shall be refunded as prescribed after deducting liability if any.

Obtaining Credit or Grant

A Cooperative Society may borrow loan or accept grant from any native or foreign bank or institution, union or from any other body or work incollaboration.

Before obtaining credit or grant from foreign bank or entity, approval of Ministry of Finance shall be obtained upon recommendation of the Ministry.If a Cooperative Society intends to obtain the security of Government of Nepal against loan to be borrowed from a foreign bank or other body, it has to make request to the Ministry of Finance through the Ministry. If such a request is received, Ministry of Finance may provide security against such loan.

5. PROVISION RELATING TO COOPERATIVE BANK

Section 12 provides that society and unions together may, with prior approval of the Nepal Rastra Bank, form Cooperative Bank with the objectives of accepting savings of society or union, to disburse credits or to provide banking services to such society or union. The National Cooperative Bank that is in operation at the commencement of this Act shall be deemed to have been formed under this Act.

The capital of Cooperative Bank shall consists of only ordinary (equity) share and the minimum capital shall be as prescribed by Nepal Rastra Bank. It may by passing resolution in the general meeting and obtaining prior approval of Nepal Rastra Bank increase its capital. It shall increase its capital as per the directives issued by Nepal Rastra Bank from time to time.

The Cooperative Bank shall, subject to this Act, Rules, Byelaws and other prevailing laws in force, carry out the following functions amongst the members of the society or union:

- To provide fixed and working capital credit to societies or unions for agriculture, industry, service, business, energy, tourism or related activities in the prescribed proportion.
- To accept savings from members and make payments of such savings.
- To make agreement and joint investment with unions, societies or entity of Government of Nepal or Provincial Government or local level for the development and promotion of cooperative sector by being concentrated to members.
- To provide guarantee on behalf of its member society or union, to obtain movable or immovable property against such guarantee or from third party with consent.
- To obtain institutional credit as per necessity.
- To recover interest of credit, bond, etc.
- To inspect, supervise and monitor as to whether the credit provided by it has been utilized or not.

- To purchase/sale bonds issued by Government of Nepal or treasury bills issued by Nepal Rastra Bank.
- To exchange information among society or unionand members associated with them.
- To accept savings, extend credit or transfer amounts through electronic instruments or devices.
- To obtain or extend credit or refinance as per necessity.
- To supply or manage sources of amounts received from cooperatives related internationally recognized organizations, donor agency, bank etc.
- To conduct or cause to conduct study, research, survey relating to establishment, operation and evaluation of project.
- To perform other banking transaction by obtaining license from Nepal Rastra Bank.

Activities Prohibited to be Carried by Cooperative Bank

Cooperative Bank shall not extend credit on the security or guarantee of its shares. It shall not declare or distribute dividend unless it has written off preliminary expenses or loss sustained in the prior years and satisfied capital fund, risk bearing fund and reserve fund. It shall not purchase goods or immovable property with the intention of doing business, other than for the purpose of transaction permissible under this Act and for its own use.

Control of Management by Nepal Rastra Bank

Section 59 provides, Nepal Rastra Bank may, in any of the following circumstances, by furnishing information to the Department, suspend the Board of Directors of the Cooperative Bank and take over the management on its own or through other agency:

- Cooperative Bank has not complied with the directives issued by NRB from time to time as per the audit report or inspection report,
- Loss has been caused by any action against the interest of the members,
- Loss has been caused by incompetent or inefficient management of the Cooperative Bank.

Before suspending the Board, the Cooperative Bank shall be given opportunity of hearing of at least seven days. In case the Cooperative Bank fails to submit the clarification or the clarification so submitted does not seem to be satisfactory, Nepal Rastra Bank may suspend the Board of the concerned bank and take the management on its own or causes the management to be taken over by any other agency. While taking over the management by Nepal Rastra Bank on its own or by any other agency, a representative of the Department shall also be involved.

Cancellation of Registration of Cooperative Bank

In case the Cooperative Bank seems incapable to pay the debt or external liability due to be paid, Nepal Rastra Bank may give advice to Registrar to cancel its registration. Before giving advice to the Registrar, the Cooperative Bank shall be provided with a period of at least 15 days to provide its clarification. If advice for cancellation of registration is received from Nepal Rastra Bank, the Registrar shall cancel the registration and appoint liquidator.

6. FUND OF COOPERATIVE SOCIETY

Fund of a Cooperative Society

The following amount shall be deposited in the fund of a Cooperative Society:

- Amount received from sale of shares,
- Amount received as savings,
- Amount received as loan,
- Amount of grant received from Government of Nepal,
- Grant or assistance received from a foreign government or an international organization,
- Amount accrued from commercial activities,
- Membership entry fee.

Approval of Ministry of Finance shall be required before receiving grant or assistance from a foreign government or an international organization.

Statutory Fund of Cooperative Society

The Act has made requirement to a Cooperative Society to maintain different categories of fund to strengthen the Organization and enhance faith and trust of members in the Cooperative system. The Cooperative Society shall maintain the following funds:

(a) Reserve Fund

There shall be a Reserve fund in Cooperative Society and the amount of the fund shall be indivisible.The following amount shall be credited in the Reserve Fund:

(a) At least 25% of net savings of the fiscal year,
(b) Capitalized grant amount provided by any institution, organization or entity,
(c) Proceeds of sale of fixed assets,
(d) Amounts received from other sources.

(b) Patronage Capital Redemption Fund

There shall be a Patronage Capital Redemption Fund in Cooperative Society. A minimum of 25% of the residual amount of net savings after providing for the amount for Reserve Fund shall be annually deposited in this Fund. The amount of the Fund shall be made available to the concerned member based on the annual turnover of the member as prescribed.

(c) Cooperative Promotion Fund

There shall be a Cooperative Promotion Fund in Cooperative Society. An amount equivalent to 0.5% of the residual amount of net saving after providing for the amount for Reserve Fund shall be annually deposited in this Fund. The Fund shall be at the Ministry of Land Management, Cooperatives and Poverty Alleviation. The operation procedure of the Fund shall be as prescribed.

For the purpose of distribution of the amount deposited in the Fund, there shall be a committee under the convenorship of the Minister of the concerned Ministry and comprising of the vice-chairman of the National Cooperative Development Board, Secretary of the Ministry, Joint

Secretary of the Ministry of Finance, chairman of the National Cooperative Federation, Chairman of the Central Savings and Credit Union and the Registrar as the members.

The Ministry may make available the amount as prescribed in proportion to the amount deposited in the Fund. Amount as prescribed shall be made available from the Fund to the National Cooperative Federation, the concerned Central Sectoral Cooperatives Union, Provincial Sectoral Cooperative Union, Provincial Cooperative Union, District Sectoral Cooperative Union and District Cooperative Union.

Out of the amount received as above, at least 75 % of the amount shall be expended in infrastructure of cooperative business and the remaining amount shall be expended in activities such as promotion of enterprises, education, information and trainings, market promotion, monitoring of society and union. The concerned union shall separately maintain record of the amount received and get it audited according to the prevailing laws and statement thereof shall be made public as prescribed. In case the amount received from the Fund, is found to have misused or used in other activity, the Registrar or the authority authorized by the Registrar shall recover such amount and prohibit making the amount of the fund available.

(d) Other Funds

There may be other funds in a Cooperative Society, in addition to the Funds referred as above. The amount in these Funds may be utilized as stated in the Bye-laws to achieve the objectives of the Fund including distribution of dividend from the concerned fund. The amount of share dividend of one year shall not be more than 18 % of the share capital.

Rule 27 provides, there shall be following other funds in the Cooperative Society:

- Cooperative Education Fund,
- Share Dividend Fund,
- Employee Bonus Fund,
- Cooperative Development Fund,
- Loss Recovery Fund,
- Community Development Fund,
- Stability Fund approved by general meeting pursuant to section 103(5) of the Act,
- Other Risk Management Fund.

7. RECORDS, ACCOUNTS AND AUDIT

Records of Cooperative Society

A Cooperative Society shall securely maintain records of decision, function and activities of General Meeting, Board and account supervision committee. It shall maintain records of transactions and other related records as prescribed.

A Cooperative Society shall submit a report containing the following details every year to the Registrar or authority authorized by the Registrar within the prescribed time:

- Quadrimestre (4 monthly) and annual report of transactions and audit report,
- Annual program, policy and plan,

- Policy and plan related to net saving,
- Name of directors and their tenures,
- Information related to meetings of general meeting,
- Share membership number and capital,
- Amount of outstanding and due credit of directors or members,
- Other details as prescribed by the Registrar or officer authorized by the registrar.

A Cooperative Society shall maintain accounts under double entry accounting system that reflects actual transaction as per accounting standards set be entity authorized under prevailing laws (Nepal Accounting Standards Board) and compliance of terms and provisions of this Act.

Audit and Appointment of Auditor

A Cooperative Society shall get its accounts of each fiscal year audited within three months from the expiry of the fiscal year by an auditor licensed according to the prevailing laws. In case any Cooperative Society is found not to have audited within this period, the Registrar or the authority authorized by the Registrar may cause the auditing of such Cooperative Society by a licensed auditor. The amount including remuneration to be paid to the auditor shall be borne by the concerned Cooperative Society.

The audit report shall be submitted to the General Meeting for approval. In case the auditing report submitted in the General Meeting could not be approved by the General Meeting, the General Meeting may appoint another auditor subject to section 76 for re-audit. The Cooperative Bank shall submit the audit report to the Nepal Rastra Bank as well after completion of the audit.

Section 76 provides the provision for appointment of auditor. The General Meeting shall appoint one auditor from amongst the auditors licensed according to the prevailing laws for carrying out audit of a Cooperative Society. Remuneration and facilities of auditor appointed by the General Meeting shall be as fixed by the General Meeting. The same person, firm or company shall not be appointed as an auditor for more than a consecutive period of three years.

Disqualification of Auditor

The following person shall not be appointed as an auditor and if already appointed shall not hold his/her office:

- Director of Cooperative Society,
- Member of the concerned Cooperative Society,
- Consultant or employee drawing regular salary from the Cooperative Society,
- One who has not completed a period of three years after having been convicted of an offence relating to auditing,
- One who has not been declared bankrupt,
- One who has not completed a period of five years after having been convicted of the offence of corruption, cheating, or any other of-fence involving moral turpitude,

- A person, firm or company referred to in sub-section (3) of section 76 (same person, firm or company shall not be appointed as an auditor for more than a consecutive period of three years),
- A person having conflict of interests with the concerned Organization or Association.

Before being appointed as auditor, the auditor shall inform in writing that he/she is not disqualified as above. In case any auditor is rendered ineligible to audit the account of any Cooperative Society before expiry of his or her term of office is over or there arises a situation due to which he/she cannot continue to remain as the auditor, he/she shall immediately stop the work he/she is carrying on and information of the same shall be furnished to the Cooperative Society in writing. The audit carried out by the auditor appointed in contravention of this section shall not be valid.

8. AMALGAMATION, DISSOLUTION AND CANCELLATION OF REGISTRATION

Provision Related to Amalgamation or Demerger

Two or more than two Cooperative Societies may be amalgamated with each other or a single Cooperative Society may be demerged (divided) into two or more than two Cooperative Societies on the basis of geographical business area subject to this Act. Decision of amalgamation or division shall be made by majority of the total number of members of concerned Cooperative Society. Terms and conditions of amalgamation or division shall be clarified in making decision.

Dissolution and Cancellation of Registration

Section 88 provides, the Board may, in regard to any Cooperative Society having taken a decision to dissolve such a Cooperative Society by majority of the then prevailing members of the General Meeting submit to the Registrar or the authority authorized by the Registrar for approval of the dissolution in the following circumstances:

- If it seems impossible to achieve the objective and functions as provided in the byelaws,
- In case it cannot serve the interests of the members.

If it is deemed appropriate to dissolve the Cooperative Society on the basis of the application, the Registrar or the authority authorized by the Registrar shall cancel registration of the Cooperative Society.

The Registrar or the authority authorized by the Registrar has the power to cancel registration of Cooperative Society in the following condition/s:

- In case it is inactive for a consecutive period of two years without any transaction,
- In case any Cooperative Society frequently commits any act in violation of this Act or Rules framed under this Act,
- In case it commits any act against its objectives referred to in the Byelaws,
- In case it commits act against values, norms and principles of cooperatives.

Before cancellation of registration, the Registrar or the authority authorized by the Registrar shall provide a time of fifteen days to such a Cooperative Society for hearing. If registration is cancelled, the Cooperative Society shall be deemed to have been dissolved.

The Registrar shall obtain approval of the Ministry before cancellation of registration of the Cooperative Society which has obtained grant amount exceeding the ceiling specified by Government of Nepal and of the Nepal Rastra Bank before cancelling the registration of the Cooperative Bank.
Rule 62 provides, if the registration of Cooperative Society is cancelled or dissolved pursuant to section 88 of the Act, the liabilities shall be settled in the following order of priority:

- Dissolution expenses,
- Refund of savings to member,
- Employee expenses,
- Payment of loan,
- Payment of other liabilities,
- Refund of capital,
- Payment of arrears (sum unpaid) dividend.

Any creditor may submit his/her claim to the Cooperative Society within 3 months of the date of dissolution proceedings. Claim submitted after the expiry of this period shall not be accepted.

If registration of Cooperative Society is cancelled pursuant to section 88, the Registrar or authority authorized by the Registrar shall appoint liquidator. The Registrar may appoint the authority authorized by the Registrar or an employee as liquidator in case of a Cooperative Society having the assets of prescribed ceiling.

9. INSPECTION AND MONITORING

Section 95 provides, Registrar or authority authorized by the Registrar may inspect or examine accounts of Cooperative Society at any time. Nepal Rastra Bank may at any time investigate or examine accounts or financial transactions of Cooperative Bank or Cooperative Society with transactions exceeding the prescribed limit. The Rastra Bank may depute any of its officers or expert to investigate or monitor by obtaining necessary details or information. It shall be the duty of the concerned Cooperative Society to provide necessary information if demanded by the Rastra Bank, Registrar or the authority authorized by the Registrar.

If activities of Cooperative Society or Cooperative Bank are in contravention of the Act, Rules, directives or procedures, the Rastra Bank or Registrar or authority authorized by the Registrar may issue directives. It shall be the duty of the concerned to comply with such directives.

Nepal Rastra Bank may use powers as per the prevailing laws while investigating or supervising the Cooperative Bank. Rastra Bank shall provide information to the Department obtained in the course of inspection or supervision of the Cooperative Bank. Cooperative Bank shall furnish financial information, statistics or other documents to the Rastra Bank within the time and format prescribed by it.

Section 96 provides, if complaint from at least 5% of total members is received alleging that transaction of Cooperative Society is unsatisfactory, act is committed against interest of members or against the objectives of the Cooperative Society, the Registrar or authority authorized by the Registrar shall investigate or cause to investigate such Organization. It shall be the duty of the Board of the concerned Cooperative Society to provide necessary documents and records to assist in the investigation. Information of investigation shall be provided in writing to the concerned Cooperative Society.

Investigation and Inspection by Union

Union shall inspect and monitor the functions and activities of its members as prescribed and provide report to the Department and Office.
The report shall contain the following details:

- Details of the society or union having the inspection and supervision carried out,
- Status of compliance of this Act, or Rules and Byelaws framed under this Act in the society or union,
- Condition of services and benefits being received by members,
- Level of participation of members,
- Economic and financial condition of the society or union and mobilization of fund,
- Other matters as prescribed.

If any fault is observed in the functions and activities of any Organization or Association under its umbrella, the Association may advice or give direction to correct such fault. It shall be the duty of the concerned Organization or Association to comply with such direction. If the advice or direction is not followed, the Association shall make recommendation to the Registrar for necessary action.

Submission of Annual Report by Registrar/Office

The Registrar shall submit annual report relating to inspection of Cooperative Society to the Ministry, and Cooperative Bank to Nepal Rastra Bank as well within 3 months of completion of fiscal year. The Office shall, within one month from the date of completion of fiscal year, submit to the Registrar the annual report of Organization or Association within its business area. The following matters shall be included in the report:

- Details of Cooperative Societys in operation,
- Number of the Cooperative Societies monitored and details of financial transactions,
- Status of compliance of cooperatives principle and of this Act and the Rules, Byelaws and internal procedures framed under this Act in the Cooperative Societies,
- Condition of services and benefits being received by the members of the Cooperative Societies,
- Participation ratio level of members in activities of the Cooperative Societies,
- Details on the economic activities and financial condition of the Cooperative Societies as prescribed,
- Condition of internal control in the Cooperative Societies,
- Condition of good governance and accountability in Cooperative Societies,
- Details of funds in the Cooperative Societies,

- Necessary matters to be helpful in policy making of cooperatives,
- Details as to registration, liquidation and dissolution of the Cooperative Society,
- Details of transactions made, and businesses, industries or projects run by Organization or Association pursuant to Section 21,
- Other details as prescribed.

10. PROBLEMATIC SOCIETIES OR UNIONS

Section 104 provides, if during the course of inspection or examination of accounts pursuant to the Act, following conditions exist in any society or union, Registrar may recommend to the Ministry to declare such society or union as problematic:

(a) Performed any activities against the interest of members,
(b) Non-fulfillment, inability or probability of non-fulfillment of liability,
(c) Inability to return savings of members as per predetermined terms and conditions,
(d) Operation of society or union in contravention of this Act, Rules, byelaws,
(e) Probability of bankruptcy or prevalent significant financial distress,
(f) In case at least 25 members of an society or union submitted an application to the Registrar stating that the society or union did not refund the savings amount of members within the time set to refund and it has been found from investigation that any of the circumstances referred to in (a) to (e) has seen occurred.

If recommendation as above is received, the Ministry may declare such society or union as problematic. Notwithstanding anything contained elsewhere in this section, in case a Commission formed by Government of Nepal according to the prevailing laws recommends to declare any society or union as problematic society or union or if such a Commission has declared any society or union as a problematic or based on the number of complaints filed in such a Commission and on rationality, the Ministry may declare such society or union as a problematic society or union.

Formation of Management Committee to Manage Assets/Liabilities [Section 105]

If any society or union is declared problematic pursuant to this Act, Government of Nepal shall form a management committee to manage its assets and payment of its liabilities. The committee shall consist of the following members:

(a) A person appointed by Government of Nepal from amongst persons who has already become judge of the High Court or worked in the equivalent position and has served as a special class officer of the Nepal Judicial Service- Chairman
(b) One person nominated by GON from amongst gazettedfirst class officers of Civil Service- Member
(c) One Director Representative designated by National Cooperative Federation- Member
(d) Two experts in the field of cooperatives nominated by Government of Nepal- Member
(e) A person nominated by Government of Nepal from amongst persons who have worked for at least a period of 3 years in at least ninth level or equivalent post of a bank or financial institution, or in the supervision sector of banks or financial institutions upon being a Chartered Accountant- Member
(f) Gazetted Second class officer nominated by Government of Nepal- Member secretary

The term of the office of the chairperson and members of the Management Committee shall be of two years from the date of appointment and Government of Nepal may extend the term of office not exceeding another two years.

Government of Nepal may terminate the chairman or members of the management committee at any time if their work performance is not satisfactory and fulfill the vacant seat according to the above procedures. Opportunity of hearing shall be provided to the chairman or member before removing him/her from the office.

The function, duties and powers of the Management Committee shall be as follows:

- To exercise all powers which the General Meeting, Board and Account Supervision Committee of the problematic society or union may exercise under this Act, or Rules and Byelaws framed under this Act,
- To get presence in the Management Committee of the members of the problematic society or union, his or her family members, relatives, employees of the problematic society or union, other society or union or companies associated with the problematic society or union, employees of such companies, other persons or organizations having relevant information or having transactions in collusion or the persons which the Management Committee deems appropriate, to inquire with them, record their statements require to submit relevant documents,
- To collect accurate information of assets and liabilities of the problematic society or union and to collect, study, analyze and evaluate the statistics relating to them,
- To take custody of assets of the problematic society or union,
- To take into control of complete management including decisions and records of functioning of the problematic society or union,
- To recover the debts, due amount or other amount to be recovered by the problematic society or union having followed the procedures of this Act or Rules or Byelaws framed under this Act,
- To sell by auction the assets under mortgage of the problematic society or union having followed the procedures of this Act or Rules or Byelaws framed under this Act,
- To sell, use and manage the assets of the problematic society or union,
- To prepare records of savings and shares amounts of depositors and members of the problematic society or Association,
- To repay of return the savings of the members and depositors,
- To exercise all powers conferred on the Liquidator by this Act or Rules or Byelaws framed under this Act for management of assets of the problematic Society or union and to pay the liabilities,
- In case it is found that director or employee of problematic Society or union or his or her family member has used whole or part of savings of depositors in any other company, or organization or in any enterprise or business, to seize the assets so used and assets accrued from it & to sell by auction such assets and to take other necessary actions of recovery for payment to depositors,
- To legally defend on behalf of the problematic society or union,
- To seize the assets of the Society or union kept in the name of a director or employee of the problematic Society or union or his or her family member or in the name of any other

person; or the movable or immovable assets purchased from the assets of the Society or union and to sell by auction such assets and to take other necessary actions of recovery for payment to depositors.

Priority in Payment of Liabilities

The Management Committee shall settle the liability of the problematic society or union in the following order of priority:

- Payment of savings to members according to the terms and conditions set at the time of depositing the amount,
- Payment of government dues or claims on the assets of such an society or union,
- Payment of persons paying advance amount to the problematic society or union for apartment or land,
- Payment of amount to the creditors of the problematic society or union.

In case assets of the problematic society or union is not sufficient to pay all liabilities of such a problematic society or union under this section, the Management Committee may refund the savings and make payment of liabilities to the members on a prorate basis. While refunding savings of members in such a manner, the Management Committee shall give priority to small depositors as prescribed.

***Ipso-Facto* Suspension of Powers of the Board & Official**

The authority of the Board, manager and employees of the problematic society or union shall, *ipso facto,*be suspended from the date of formation of the Management Committee under this Act. However, the Management Committee may for the purpose of management of assets and payment of liabilities, release the suspension and engage the members, manager and employees of the problematic society or union for carrying out functions relating to management of assets and payment of liabilities of such society or union. If management Committee has mobilized such individual, it shall be the duty of the individual to fulfill his/her responsibility.

Corrective (Remedial) Action on Problematic Society or Union

The management committee shall conduct audit of the problematic Society or Union within 6 months of taking under its control and publish report publicly. The Management Committee may in case there are reasons and bases that the problematic Society or Union could operate again based on the audit report, carry out the following remedial actions:

- To order the Board to carry on management or functions and transactions,
- To ask to carry on management or functions and transactions having formed an interim committee from amongst shareholding members of the concerned Society or Union,
- To dissolve the Board and call a General Meeting of such Society or Union and to cause to form a new Board for carrying on management or functions and transactions,
- In case the Central Sectoral Cooperative Society in which the concerned Society or Union is a member or the National Cooperatives Federation submits a credible action plan for resuming the operations of the problematic Society or Union, to assign such responsibility by prescribing the terms and conditions,

- To take other reformatory and remedial measures which the Management Committee deems appropriate.

Submission of Report

Management committee shall submit report clarifying the following details to the Ministry within one months of completion of activities related to management of property and payment of liabilities of problematic Society or Union:

- Refund of members amount of savings,
- Liabilities paid,
- Details of the remaining assets and liabilities,
- Recommendations relating to policies to be adopted by Government of Nepal with regard to operation of an Society or Union,
- Other details as deemed appropriate by the Management Committee.

11. OFFENSE, PUNISHMENT, FINES & APPEAL

Offense

Section 122 provides, if anyone does any of the following activities, it shall be deemed as offense under this act:

(a) Operation of a Cooperative Society without registration or a Cooperative Society registration of which has been revoked, or carrying out transaction or business or services or other activity with the use of the word "cooperative" or its translated version in English language for purpose other than under this Act, Rules and byelaws.
(b) Use of savings of members for any purpose other than the purposes stated in this Act or Rules or Byelaws framed under this Act.
(c) Extending credit more that the prescribed limit, doing so without security or guarantee.
(d) Misappropriation of property, savings or shares of cooperative institution by the members of Board, managers or employees.
(e) Misappropriation of amounts by extending credit where it cannot be recovered to any member of Board, their families, or other person or employee.
(f) Where any member of Board acting alone or in coalition (collusion) with other members, mobilizes Cooperative Society's shares or savings amount on their own wish causing harm to the Cooperative Society.
(g) Acquiring credit by furnishing false or incorrect details, collateral for credit is valueless or misappropriation of credit.
(h) Investment or collection of amounts for investment in violation of the Act or Rules or Byelaws.
(i) Extending or acquiring credit by establishing or making establish artificial business.
(j) Extending or acquiring credit by irregularly high valuation of collateral.
(k) Extending or acquiring credit by irregularly high valuation of costs of projects on the basis of false details.
(l) Providing additional credit without procedurally releasing collateral already secured against credit, or in value excess of that bearable by the collateral to any person or Cooperative Society.
(m) Use of credit for the purpose other than the purpose of acquiring the credit.

(n) Commit forgery by removing or erasing any information in any document, accounts and write or keep a separate record so as to give a different meaning than what was originally intended in order to cause gain or loss to self or other person or by making or make other to make signed documents stating false matters that is not actually true or did not actually happen, by misstating date, amount or nature with the intention of causing loss or damage to others.
(o) Making high, low or otherwise incorrect valuation of movable or immovable property for the auction sale or other purpose, causing loss or harm to the Cooperative Society by the valuator.
(p) If anyone with the intention of causing loss or harm to the Cooperative Society makes someone do or not to do any work, does or cause bias, receiving or giving any kind of amount, receiving or giving goods or service without value or in less value or donating, gifting, or collecting or giving donations, preparing or make to prepare false writings, translation or doing or making to do any kind of illegal activities with the intention of gain or loss.
(q) Performing audit or providing false audit report or making to do so with the intention of causing harm to any Cooperative Society, its members or depositors.

Punishment [Sec. 124]

Whoever commits any of the offences referred to in Section 122 shall be liable to the following punishments:

(a) For commission of the offences referred to in clauses (a), (c), (m) and (q), an imprisonment up to one year and a fine up to one hundred thousand rupees.
(b) For commission of the offence referred to in clause (l), an imprisonment up to two years and a fine up to two hundred thousand rupees.
(c) For commission of the offence referred to in clause (b), fine equal to the claimed amount and an imprisonment up to three years.
(d) For commission of the offences referred to in clauses (d), (e), (f), (g) (h), (i), (j), (k), (o) and (p), the claimed amount shall be recovered and equal amount shall be fined and following amount of imprisonment shall be imposed:
    (i) If the claimed amount is up to one million rupees, imprisonment up to one year,
    (ii) If the claimed amount is above one million rupees and up to five million rupees, imprisonment from two to three years,
    (iii) If the claimed amount is above five million rupees and up to ten million rupees, imprisonment from three to four years,
    (iv) If the claimed amount is above ten million rupees and up to one hundred million rupees, imprisonment from four to six years,
    (v) If the claimed amount is above one hundred million rupees and up to one billion rupees, imprisonment from six to eight years,
    (vi) If the claimed amount is what so ever amount above one billion rupees, imprisonment from eight to ten years.
(e) For commission of the offence referred to in clause (n), an imprisonment up to ten years.

Who ever attempts or abets or assists to commit any offence referred to in Section 122 shall be liable to half of the punishment which the offender in the first degree is liable to. In case any

Society or Union abets or assists to commit any offence referred to in section 122, the chief executive or official or the person working in the capacity of an executive shall be liable to the punishment according to this Act.

Government of Nepal shall be the plaintiff in lawsuits filed for offenses under this section and such lawsuit shall be deemed to be included in schedule 1 of Government Case Act, 2049. The lawsuits under this section shall be initiated and decided by the concerned district court. Complaint for offense under this section shall be made within 90 days of the knowledge as to the offense committed or about to be committed.

Power of the Registrar to Impose Fine

If any of the following act is proved to have been done by any person on the basis of complaint received by any person or during inspection, investigation or examination of accounts, the Registrar may, considering the nature and seriousness of the act, levy fine up to 5 lakh rupees to the concerned person:

- Charging interest to member in contravention of this Act, Rules,
- If spread between interest in savings and credit is more than 6%,
- Charging of interest by capitalizing interest into principal,
- Extending credit to member exceeding the prescribed percentage of capital,
- Extending credit to members, other than those members who are listed at the time of registration of the organization, w`ithout completing a period of three months after acquiring the membership,
- Collection of savings exceeding 15 times of primary capital fund,
- Distribution of share dividend exceeding 18% of share capital,
- Conducting transaction outside its jurisdiction or with non-members,
- Providing membership to artificial person in contravention of this Act.

If any of the following acts has been done, the Registrar or the authority authorized by the Registrar may, by considering the nature and seriousness of the act, levy fine up to 3 lakh rupees:

- Non-compliance of direction or prescribed benchmark (standards) under this Act, or Rules,
- Non-submission of any details, documents, reports, notice or information to be submitted under the Act, or Rules,
- Alteration of members of the Board or account supervision committee as per own choice without election pursuant to this act,
- Non-compliance with the terms and conditions as mentioned in section 15(4),
- Activities performed in contravention to the Act or Rules.

The authority to levy fines as above to Provincial Sectoral Cooperative Union, Provincial Cooperative Union, Central Sectoral Cooperative Union, Specialized Cooperative Union, National Cooperative Federation and Cooperative Bank shall be with the Registrar and with respect to Cooperative Society, District Sectoral Cooperative Union and District Cooperative Union shall be with the authority authorized by the Registrar.

If a person or Cooperative Society fined under this section repeats the offense, the Registrar or the authority authorized by the Registrar may levy double punishment from the second time of offense for each violations.

The Registrar or the authority authorized by the Registrar in addition to levying fine pursuant to this section may make recommendation to concerned entity to freeze the transaction, property and bank account of the Cooperative Society up to 3 months. If such recommendation has been received, the same shall be done and information shall be given to the Registrar or the authority authorized by the Registrar.

Punishment to Cooperative Bank by Nepal Rastra Bank

Section 128(1) provides, notwithstanding anything contained else where in this Act in case of violation of terms prescribed in license, directives issued from time to time, or issued in the course of inspection, supervision or monitoring, Nepal Rastra Bank may impose following punishment to Cooperative Bank:

(a) To make aware or give written warning,
(b) To take written confirmation from board of director to take corrective actions,
(c) To issue written order to end frequent violation or take corrective actions,
(d) To fully or partially ban transactions,
(e) To suspend or revoke license of the institution.

Similarly, sub-section (2) provides, if director or employee violates order or terms of license issued by Nepal Rastra Bank, does not provide document, details, records or information in the course of inspection or supervision within the prescribed time or acts in contravention of interests of member or depositors, it may impose following punishments to such director or employee of Cooperative bank:

(a) To make aware or to give written warning,
(b) To suspend him/her,
(c) To fine up to 5 lakh rupees,
(d) To order the Board to hold salary, allowance, and other facilities,
(e) To order the Board if the person is a director to remove from post, or if a person is an employee, to take legal action as per terms of services of the employee.

Right to Appeal [Sec. 133]

A person who is not satisfied with the decision of denial to registerCooperative Society pursuant to Section 16 or of revocation of registration of Cooperative Society pursuant to Section 88 may, within thirty five days from the date of getting information of the decision, file an appeal to the Registrar in case the decision has been made by the authority authorized by the Registrar and to the Secretary of the Ministry in case the decision has been made by the Registrar.

The person who is not satisfied with the decision of fine referred to in Section 125, and of the punishment imposed pursuant to clauses (d) and (e) of sub-section (1) of Section 128 and clauses (c), (d) and (e) of sub-section (2) of the same section, he/she may file an appeal as follows within thirty five days from the date of getting information of the decision:

- To the concerned district court in case the decision has been made by the authority authorized by the Registrar,
- To the concerned High Court in case the decision has been made by the Registrar.

12. MISCELLANEOUS

Byelaws and Internal Procedures

Cooperative Society shall frame byelaws for conducting its business subject to this Act, Rules, Directives, Standards and Procedures framed under this Act. The byelaws shall come into force after approval of the Registrar or the authority authorized by him or her. The Registrar shall obtain consultation of Nepal Rastra Bank before approving byelaws of the Cooperative Bank.

Cooperative Society may frame byelaws as may be necessary for conducting its business subject to this Act, Rules, Directives, Standards and Procedures framed under this Act. The internal procedures shall come into force after it is approved by the General Meeting.

The byelaws and internal procedures may be amended by the majority of the total number of members of the General Meeting of the Cooperative Society. The amendment to the byelaws shall come into force after the approval of the Registrar or the authority authorized by him or her.

Recovery of Debt [Sec. 79]

In case any member of a Cooperative Society fails to comply with the loan agreement or any terms or condition or bond thereof, does not repay the principal, interests and penal interests within the time stated in the deed, or the amount of loan is not used in the current scheme for which it was availed and found embezzled, the concerned Cooperative Society may recover its principal, interests and penal interests having sold by auction the collateral security mortgaged by such a member while availing the loan or by any other means.

In case a member who has mortgaged a collateral in a Cooperative Society transfers the title of such collateral to anyone in any manner or the value of such collateral decreases for any reason, such borrower may be asked for additional collateral having given a certain time frame. In case the borrower does not submit additional collateral or the principal, interest and penal interests could not be recovered even from the collateral security mortgaged as above, the principal, interests and penal interests may be recovered from other assets belonging to such borrower. The amount remaining after recovery of the principal, interest and penal interests or the expenses incurred while making the recovery of the principal, interest and penal interest shall be refunded to the concerned borrower.

While selling by auction of collateral security or any other assets of a borrower by a Cooperative Society under this section, it shall write to the concerned Land Revenue Office to transfer the title of such collateral security, by registration or writing off the name of the earlier owner, in the name of the person accepting the auction according to the prevailing law and the concerned Office shall also have to carry out registration or the writing off the title and inform the same to the concerned Cooperative Society.

In case the assets of collateral mortgaged in auction under this section is not accepted by anyone, the concerned Cooperative Society may itself accept such assets. In case the Cooperative Society itself accepts the collateral, it shall write to the concerned Land Revenue Office to transfer the title of such a collateral by registration or writing off the name of the earlier owner and the concerned Office shall also have to carry out the registration or the writing off accordingly.

Provision Related to Credit Information Center and Black Listing [Sec.80 &81]

The Ministry shall, in order to maintain purity in credit flow of a Cooperative Society and to receive information relating to credit flow, establish a Credit Information Center in collaboration with stakeholders.

Credit Information Center shall publish the name of person misusing or not paying credit of its member Cooperative Society. The Credit information Center shall before publishing the black list obtain recommendation of its member Cooperative Society. The name of the persons can be removed from the black list by the Credit Information Center upon the recommendation of the member Cooperative Society.

Registrar

The Ministry shall designate an officer working in the capacity of gazetted first class officer or equivalent rank of the civil service as the Registrar of the Department. In addition to the function, duties and powers mentioned in the Act, the function duties and powers of the Registrar shall be as follows:

- To register Cooperative Society and issue certificate of registration.
- To approve bye-laws of the Cooperative Society within the ambit of the Act and the Rules.
- To function relating to the amalgamation, demerger and redefining jurisdiction of the Cooperative Society.
- To inspect Cooperative Society on a regular basis, check books of accounts and issue directives if necessary.
- To monitor the audit of Cooperative Society on a regular basis and cause to audit of the Organization which has not performed audit in the prescribed time.
- To formulate plan and program and implement as approved self-employment industry based on cooperative agriculture or labour or skill of member of deprived rural women, handicapped person, 'muktakamaiya', 'muktahaliya' landless farmers and unemployed persons.
- To assist projects relating to cooperative business and cooperative produce increment.
- To coordinate in the formulation, operation and extension of cooperative education and training programs.
- To issue necessary directive for the development of Cooperative Society, cooperative principles, values and maintaining governance in Cooperative Society.
- To levy fine or other punishment to the Cooperative Society in violation of the Act, Rules or byelaws.
- To submit annual cooperative inspection report to the Ministry within 3 months of expiry of fiscal year.
- To do necessary work to bring the inactive 'Sagha Sahakari Sanstha' into active status.

- To give approval for the operation of service center, collection center and sales center of Cooperative Society by determining necessary criteria.
- To perform other functions as per the Act, Rules, Procedures and directions received from the Ministry.
- To delegate as per necessity any of his/her authority to his/her sub-ordinate officers.

Stabilization Fund [Sec. 103]

Savings and Credit Sectoral Societies may together establish a Stabilization Fund to protect themselves from the probable risks of their operational losses. The Fund may have the contribution of desirous Cooperative Societies, Cooperative Societies which are members of Savings and Credits Sectoral Central Cooperative Union, National Cooperative Federation, National Cooperative Bank, National Cooperative Development Board, Nepal Rastra Bank, Ministry, other agencies of Government of Nepal and international cooperative unions. The Fund shall be located at Savings and Credits Sectoral Central Union.

There shall be an operation committee comprising of representatives from the Savings and Credits Sectoral Central Union, National Cooperative Bank, National Cooperative Federation, National Cooperative Development Board, Nepal Rastra Bank, Ministry, Ministry of Finance and Department for operation of the Stabilization Fund. The participating organizations may deposit the amount prescribed after allocating amount for the Reserve Fund pursuant to section 68 in the Stabilization Fund. Amount of the Fund shall be deposited in an account opened in the prescribed bank.

The Stability fund may be utilized for the following purposes:

- To maintain liquidity in the participating societies and to lend to maintain problematic cooperatives,
- To bear the expenses of the Management Committee formed pursuant to Section 105 when a participating society becomes a problematic,
- In case a participating society becomes a problematic and the Federation has taken over its operational responsibility pursuant to clause (d) of Section 114, to utilize in bearing liabilities of such a society and to re-operate it,
- To bear the expenses of the Stabilization Fund operational committee and to utilize in other functions as prescribed.

Special Provisions Related to Operation of Society [Sec. 135]

Notwithstanding anything contained elsewhere in this Act, buildings, land and similar type of other immovable property of organizations such as *Sajha Yatayat*, *Sajha Prakashan*, *Sajha Swastha Sewa*, *Sajha Bhandar*, *Sajha Sewa* which are under the ownership or control of Government of Nepal, Provincial government or local level and having fifty one percent of share ownership of Government of Nepal at the commencement of this Act shall not be sold, mortgaged and leased for a period of more than five years without approval of Government of Nepal.

Government of Nepal, Provincial government or local level shall accord priority for management of services to be rendered by the organizations referred above and collaboration may also be worked out by providing financial assistance to such organizations. Notwithstanding anything contained elsewhere in this Act, other provisions as to operation and management of such organizations shall be as prescribed.

Exercise of Voting Rights [Sec. 136]

Irrespective of the number of shares prescribed by any member, for the purpose of the operation of concerned Cooperative Society, he/she may exercise the voting right in the operation of functions of the concerned Cooperative Society based on one member, one vote principle.

In case of an Union, more than one representatives may be sent as prescribed for the purpose of taking part in General Meeting and provisions concerning sending of the representatives shall be as prescribed. However, no more than one member may be elected from one society or union in the Board or Account Supervision Committee of the concerned Union.

Social Audit

Section 137 provides, for the achievement of objectives as per the byelaws of the Cooperative Society, social audit may be conducted as to the decision and activities performed by the Board, services and level of satisfaction received by the members, improvement of lifestyle as to financial, social, culture and environmental aspects and positive changes. The Board shall present the report of the social audit in the General Meeting for discussion. The General Meeting shall discuss the audit report and may issue necessary directives to the Board if deemed necessary. Copy of social audit report shall be provided to the Registrar or authority authorized by the Registrar and to the Rastra Bank as well in case of Cooperative Bank.

Directive on Anti Money Laundering to be Followed [Sec. 150A]

Cooperative Society shall follow directive on Anti Money Laundering and Combating Financing on Terrorism issued by the authority pursuant to the prevailing laws. The directive shall also be applicable to Cooperative Societies registered or operated pursuant to Provincial or Local Cooperative laws. Provincial Government or Local Level shall implement or cause to be implemented the directives to Cooperative Societies registered or operated pursuant to Provincial or Local Cooperative laws.

CHAPTER- 12

INSOLVENCY ACT, 2063

1. INTRODUCTION

This is a new legislation to regulate and make the process of winding up of Insolvent Companies faster. Previously the winding up of companies was provided in the Companies Act itself. But now the Companies Act has provision for winding up of solvent companies which can pay all its liabilities. This legislation makes special provision for the winding up of insolvent companies to be supervised by the commercial bench of High Court, which deals with all commercial disputes relating to companies.

No insolvency proceeding can be started against a company without an order from the court. The court here means the commercial bench of the notified court viz. High Court. This Insolvency Act, 2063 applies for liquidation of companies only. For the purpose of this Act, company means a company incorporated under Companies law in force, and this expression also includes such other body corporate with limited liability as specified by the Government of Nepal by notification in the Nepal Gazette [Sec. 2(a)].

Unless the subject or the context otherwise requires, in thisAct,

(a) "Company" means a company incorporated under the companies law in force, and this expression also includes such other body corporate with limited liability as specified by the Government of Nepal by notification in the Nepal Gazette;
(b) "Being insolvent" means a state of being unable, or appearing to be unable, to pay any or all of the debts due and payable to or payable in the future to creditors or a situation where the amount of liabilities of a company exceeds the value of the assets;
(c) "Financial difficulty" means a situation where company becomes or may become insolvent immediately or in the near future if the company is not restructured made pursuant to this Act;
(d) "Liquidation of company" means a situation where the registration of a company is canceled by fulfilling the procedures referred to in this Act;
(e) "Restructuring" means a process to be adopted under this Act in order to a company which may become insolvent because of financial difficulty;
(f) "Restructuring program" means a restructuring program as referred to in Chapter-4;
(g) "Court" means the commercial bench of such court as designated by the Government of Nepal, in consultation with the Supreme Court, by notification in the Nepal Gazette;
(h) "Debt" means a certain amount due and payable immediately or as claimed due and payable;
(i) "Creditor" means a person who is entitled to receive payment from a company which has become insolvent or may become insolvent; and this expression also includes a secured creditor;
(j) "Security" means any or all property furnished as pledge, mortgage or any other kind of security of a debt;
(k) "Secured creditor" means a creditor that lends money to a company against a security;
(l) "Company being liquidated" means a situation where an order has been issued under this Act for the liquidation of the company;
(m) "Office" means the Insolvency Administration Office established pursuant to Section 65;

[Note: As per section 65, after the commencement of this Act, the Government of Nepal shall establish an Insolvency Administration Office, by notification in the Nepal Gazette. Pending the establishment of such Office, the Government of Nepal may designate any of its offices to perform the functions of the Insolvency Administration Office. Accordingly, GoN has designated Office of Company Registrar to perform its functions].

(n) "Insolvency practitioner" means a person licensed under Section 64 to carry on business relating to insolvency;

(o) "Inquiry officer" means an inquiry officer appointed pursuant to Section 10;

(p) "Restructuring manager" means a person who is appointed by order of the Court pursuant to Sub-section (2) of Section 22 to operate and manage the restructuring program of a company;

(q) "Liquidator" means a person who is appointed by an order of the Court or a resolution adopted by a meeting of creditors to liquidate the affairs of a company, and this expression also includes the Office;

(r) "Associated person" means any director, officer, shareholder of a company which has become insolvent or any director, officer or shareholder of a company that is holding or subsidiary company of such company; and this expression also includes the husband, wife, son, daughter, adopted son, adopted daughter, father, mother, stepmother, elder brother, younger brother, elder sister, younger sister of any director, officer, shareholder of that company or of a company that is holding or a subsidiary of such company;

Hence, a company is considered to be 'insolvent' if it is unable or appear to be unable to pay all or any of the debts due and payable to, or payable in future to creditors or a situation where the amount of liabilities of company exceeds the value of itsassets. To get the permission of the Court to start insolvency proceeding against any company, any of the following persons may make a petition to the court(Sec. 4)

(a) The company 'being insolvent' itself;

(b) Out of the total creditors of a company 'being insolvent', at least ten percent creditor or creditors who has or have lent money;

(c) Shareholder or shareholders holding not less than 5% of the shares, among the total shareholders;

(d) Debenture holder or holders holding not less than 5% of the debentures among the total debenture holders;

(e) Liquidator appointed to wind up the company (while being considered as solvent at that time of liquidation);

(f) A body authorized to administer and regulate such business, in the case of company that carries on any specific type of business set forth in Section 8. Like:

i. In the case of banks and financial institution, Nepal Rastra Bank,
ii. In the case of Insurance Companies, The Insurance Board,
iii. In the case of any other Companies which cannot be wound up without the approval of any authority, such authority.

Without this permission, no petition for insolvency can be filed by anybody.

Before submitting the petition to the Court, 35 days must have elapsed from the date of giving proper notice to pay off the debt to the company. While submitting the petition to the Court, the following particulars should be submitted:

(a) Reason for filing the petition;
(b) Summary particulars of company's financial position;
(c) Evidence that company has become insolvent.

Additional particulars are to be submitted as follows in the following circumstances.

In the case of petition being filed by the company 'being insolvent' itself:

(a) Resolution of the Board confirming that the company has become insolvent;
(b) Special Resolution of the Board of Directors that the company proceed to start insolvency proceedings;
(c) A certified copy of the Balance Sheet and audit report available at the time of filing the petition.

In case the petition is filed by theCreditors:

(a) Particulars of the principal and interest amount claimed by the creditors as payable.
(b) The date the loan/credit was given to the company along with the reason for the same
   i. If it is a loan given by promissory note / 'tamasuk' then the copy ofthe promissory note / tamasuk could be provided.
   ii. If the payment for supply of goods, purchase order of the company, invoice of the goods supplied, the receipt for the goods supplied and receipt issued for the same by the company.
(c) Particulars of the balance amount due and that it is currently due.
(d) The belief of the creditors that the company is'being insolvent', with reason and evidence for such belief.

In case liquidator appointed by the shareholders when the company was declared solvent and later liquidator is satisfied that the company is insolvent:

(a) Proof / evidence that he was appointed the liquidator of the company in respect of which he wants to file the petition;

Liquidator's opinion regarding company in respect of which application is made for insolvency proceedings is 'being insolvent', and the ground for such opinion.

In the case of shareholders / debenture holders desiring to file a petition for insolvency, they shall seek prior approval of the Court for filing such petition and only after receiving such approval, the petition may be filed. Normally, the Court shall not give such approval unless sufficient evidence to prove that the company 'being insolvent' is submitted.

In the case of petition by creditors, notice to the company to pay off the liability should be given to the registered office of the company in the prescribed form duly signed by the creditor or his authorized representative prior to making an application to the Court (Sec.5).

On receipt of such notice, if the liability is not currently payable, the company may make an application to the Court to invalidate the notice within 35 days of receipt of such notice. On receipt of such application, the court shall give notice to the creditor along with a copy of the company's application to present at the court within seven days. If the creditor presents himself before the court or if absent till the period of expiry of the time given, then the court may decide on the invalidation of notice within seven days and may invalidate the notice in the following cases:

i. If there is dispute in the matter whether the creditor has lent the money to the company or not or;
ii. If the loan has not matured for payment at that time.

So long as the above conditions exist, no further petition to give notice to pay the loan to the company or to make application for insolvency proceedings may be filed.

If the court does not pass an order invalidating the notice, the company shall pay the amount due within 35 days from such date. (Sec. 6)

Company Deemed to Have 'Being Insolvent'

Unless otherwise proved, the company shall be deemed to have'being insolvent' in the following cases:

(a) If the general body of the shareholders passes a special resolution that the company has 'being insolvent' or the Board of Directors passes such are solution;
(b) If the court has ordered the company to pay the loan or liability and the company did not discharge the loan or liabilities within 35 days of the receipt of the order;
(c) When the creditor has issued notice to the company to pay the loan amount and the company did not pay the amount within 35 days or did not file a petition to the court to invalidate the notice within that time.

If it is proved from any other matter that the liabilities of the company exceeds the value of its assets or if the company itself accepts that it has 'being insolvent', then there is no necessity to establish that the company has 'being insolvent'.

Action to be taken on the Petition [Sec. 9]

If the petition has been filed as per Sec. 4 and submitted properly according to this Act, the Court shall fix hearing date within 15 days by registering the petition. Except where the company itself has filed the petition, the court shall send a notice to the company at its registered office asking it to show cause, in case the petition is not to be proceeded with.

If the court considers it necessary, it may send a notice to the regulating authority even before the hearing date fixed asking to file its opinion as to any reason, if any, that the petition shall not be proceeded with. And such notice shall be given to all concerned persons like shareholder, creditor or persons who are having transactions with the company or the stock exchange, if the company is listed with the stock exchange through a public notice published in a national level

daily newspaper at least two times. Any person objecting to proceeding with the petition shall make his submission with evidence within the time given by the court.

Once hearing on the petition is started, the hearing shall be continued till the final decision is given on a day to day basis. After final hearing, the court shall give an order either to start the proceeding for insolvency or not to start. If it decides to start proceeding, it may order the appointment of an appropriate investigating officer from among the insolvency practitioners kept in the list maintained by the court to investigate the affairs of the company. (Sec.10)

In case the Court finds during the hearing that other persons having transactions with the company may be affected, pass an interim order on the petition on its own *(suo motu)* under the following circumstances:[Sec.11 (1)]

(i) There has been or there is a possibility of, unlawful or wrongful sale of property of the company;
(ii) If the management of the company has not been carried out properly;
Any legal proceedings having unfavorable effects on the assets of the company to be instituted or such action is going to be enforced or there exists a possibility of such enforcement in such a manner as to prejudice the assets of the company.

While passing interim order, the Court may issue order restraining from doing any or all of the following acts: [Sec.11(2)]

(a) Transferring, selling and disposing of, or otherwise mortgaging or pledging, any assets of the Company, other than carrying on that business of the company which it has been carrying on in the ordinary course of business;
(b) Transferring the shares of the company in any manner or altering the status of the shareholders of the company in any manner;
(c) Withholding or foreclosing any assets of the company by any person; or
(d) Instituting any legal action or keeping on such action or taking any action or foreclosing by any creditor or person against the assets of the company or any assets owned or possessed or foreclosed by the company.

Where an order is issued as above, copy of the order shall be sent to the concerned company, Office of Company Registrar and Insolvency Administration office. If the Court thinks necessary, it may issue order to publish the order in a national level daily newspaper for public information.

The court may also order the appointment of an interim administrator for interim management of the company during the currency of the interim order with such functions, duties and powers that the court may prescribe.

If the court issues an order for inquiry into the insolvency proceedings, or dismisses the petition, the interim order will *ipso facto* become ineffective.

Application filed pursuant to Sec. 4 for insolvency proceedings cannot be withdrawn except as permitted by the court. (Sec.12)

2. INQUIRY INTO INSOLVENCY PROCEEDING

Where the Court issues order to inquire into insolvency proceedings pursuant toSub-section (3) of Section 10, the inquiry officer shall independently inquire into the financial situation of the concerned company in order to determine the following, whether or not

(a) There should be issued an order for immediate liquidation of the company due to reason that its financial situation cannot be improved;

(b) The period of inquiry as referred to in Section 14 should be extended;

(c) there should be issued an order for the restructuring of the company through the restructuring program;

(d) The company has become or is likely to become insolvent.

The inquiry officer shall make inquiry pursuant to above and submit an inquiry report to the Court within the period specified by the Court, and such report shall contain, inter alia, the resolution, if any, adopted by the meeting of creditors, the company's report and evaluation and recommendation made by the official. (Sec.13)

Management of Company during Inquiry Period [Sec.15]

(1) Notwithstanding anything contained in the laws in force, the board of director of the company shall carry out the management and ordinary transactions of the company during the period of inquiry of insolvency proceedings, under the regular supervision of the inquiry officer.

(2) Notwithstanding anything contained in Sub-section (1), where the inquiry officer submits to the Court a report indicating that the board of directors of the company has not operated the company properly, the Court may issue an order to remove the board of directors and order the inquiry officer to carry out the management and ordinary transactions of the company.

(3) Where the Court orders the inquiry officer to carry out the management and ordinary transactions of the company pursuant to Subsection (2), the inquiry officer shall carry out the transactions accordingly.

(4) Where any special transaction such as the sale of the assets or business of the company shall be carried out in the course of operating the ordinary business of the company pursuant to Sub-section (3), an application setting out the reason there for shall be made to the Court for permission, and where the Court issues an order granting such permission, the inquiry officer may carry out such transaction.

Report to be Made by Director

A person who has held the office of director of the company at the time when the Court has issued an order to inquire into insolvency proceedings pursuant to Sub-section (3) of Section 10 or during the period of one year prior thereto, shall submit to the Court a report on the financial situation and transactions of the company as at the time of his or her retirement, in the prescribed format.

Power to Raise Loans [Sec. 17]

(1) Where the inquiry officer considers the need of any amount to be kept in the company or operate the ordinary transactions of the company, the inquiry officer may borrow loans from any person, with or without furnishing necessary security.
(2) Any loans borrowed pursuant to Sub-section (1) shall be deemed to be the amount spent during the period of inquiry into insolvency proceedings and such amount shall be paid in order of priority as provided in thisAct. However, where the security furnished by the company to borrow a loan has already been furnished as a security with any person, the order of priority shall not apply in relation to the claim for security except in the case where the inquiry officer has made an agreement with a person entitled to claim the same.

Submission of Report by Inquiry Officer [Sec. 18]

(1) The inquiry officer shall inquire into the financial and business situation of the company and submit a report thereof to the Court within the period of inquiry.
(2) The inquiry officer shall determine any one matter set forth in Sub- section (1) of Section 13 and make a recommendation report referred to in Sub-section (1) containing the reasons and grounds for such determination, and such report shall contain, inter alia, the actual financial situation of the company, details obtained by the inquiry officer upon making inquiry and his or her opinion and findings.
(3) Where the recommendation made pursuant to Sub-section (2) has been submitted to the meeting of creditors, whether a majority of the creditors attending such meeting has accepted such recommendation or not shall also be mentioned.
(4) A copy of the report submitted pursuant to Sub-section (1) shall be sent to each of the concerned company and the Office; and the concerned company and the Office shall make arrangements to maintain the report so received that the shareholders, directors and creditors of the Company may inspect such report.

Ipso Facto Suspension [Sec. 19]

(1) Notwithstanding anything contained in the laws in force, where the Court issues order to institute insolvency proceedings in relation of any company pursuant to Sub-section (2) of Section 10, any of thefollowing acts or actions shall not be done or taken; and any acts or actions being done or taken but not completed shall *ipso facto* be suspended:
(a) Transferring, selling and disposing of the shares of the company or altering the status of any shareholder;
(b) Transferring, selling and disposing of any assets of the company or mortgaging or pledging the same as collateral in any manner;
(c) Foreclosing any assets of the company or realizing any security according to any judgment or order;
(d) Preempting any property leased to the company by the lessor or instituting any legal action in relation thereto;
(e) Paying any debt whose payment was outstanding or which had become payable at the time when the court made order to institute insolvency proceedings pursuant to Sub-section (2) of Section 10 or pledging of a security in consideration thereof; and
(f) Transferring or withdrawing moneys of the fund of the company.

(2) Notwithstanding anything contained in Sub-section (1), where any person makes an application to the Court claiming that the automatic suspension of any transaction pursuant to the said Sub-section will cause a loss to that person, the Court may, if it holds that the statements of the applicant are reasonable and that this does not prejudice the interests of the company or its creditors, issue an order to do any transaction.

Meeting of Creditors [Sec. 21]

(1) The inquiry officer shall, before submitting his or her report to the Court, convene a meeting of the creditors of the company to discuss his or her report in order to know the views of the creditors on the future plan of the company which has become insolvent, and every person whois identified as a creditor of the company from the accounts and other records of the company shall also be invited to attend such meeting.
(2) A notice indicating the venue, date, time and agenda of the meeting shall be given to every person identified as a creditor under Sub-section (1) in advance of at least seven days, and the notice shall also be published at least two times in a daily newspaper of national circulation.
(3) While giving a notice pursuant to Sub-section (2), it may be given by a letter, telex, facsimile, e-mail or any other means of electronic communication which can be recorded.
(4) Where any person other than a person mentioned in Sub-section (1) makes any claim against the company as a creditor, the inquiry officer may ask that person to submit evidence thereof and detailed description of the claim against the company.
(5) The inquiry officer may dismiss the claim of a person who fails to submit the evidence or description referred to in Sub-section (4); and where the claim is so dismissed, such person shall not be entitled to attend the meeting ofcreditors. However, a person shall not be considered to be a creditor of the company merely due to the reason that the person has taken part in the meeting of creditors.
(6) The inquiry officer shall chair the meeting of creditors.
(7) The meeting of creditors shall make decision by majority. In the event of a tie, decision shall be made by drawing lot. The inquiry officer may ascertain the voting right of creditors in proportion to the claim made on the debts due to be paid immediately by or payable by the Company and specify the mode of voting.
(8) The directors of the company or the officers invited by the inquiry officer may participate in the meeting of creditors. Provided that, they shall not be entitled to take part invoting.
(9) Except where any concerned person makes an application to the Court showing the reasons and grounds that injustice has been done to that person, no question may be raised in any court regarding the meeting of creditors and the business executed by it.

Since creditors are the most affected by the insolvency of the company, meeting of creditors is made necessary.

Power of Court to Make Order [Sec. 22]

(1) The Court may, if it considers appropriate, make any of the following orders, within seven days after the receipt of the report submitted by the inquiry officer pursuant to Sub-section (1) of Section 18, the resolution adopted by the meeting of creditors or the restructuring scheme submitted by the company or any other resolution a dopted:

(a) To liquidate the company immediately;
(b) To implement the restructuring program of the company;
(c) In the event of possibility of improvement without liquidating the company immediately, to stay until the period specified by the court;
(d) To extend the period of insolvency proceedings as specified by the Court for the submission of report by making further inquiry; or
(e) To quash the order issued pursuant to Sub-section (2) of Section 10.

(2) Where an order is made under Sub-section (1) to liquidate the company or implement the restructuring scheme, the Court shall make an order to appoint an insolvency practitioner as the liquidator of the company or to operate the restructuring scheme of the company and implement the liquidation or restructuring scheme of the Company; and the person so appointed shall perform such act within such period as specified by the Court at the time of his or her appointment.

(3) Notwithstanding anything contained elsewhere in this Section, where the inquiry officer makes an application for any of the following orders as per the understanding reached between any company which has become insolvent or of which situation requires its immediate liquidation or showing the reason that even though a company has become insolvent, there is a situation that the proposal on the restructuring scheme prepared for the improvement of the company can be considered in a meeting of creditors to be convened pursuant to Chapter-4, the Court may, if it considers so appropriate, make such order:
(a) To end the inquiry into insolvency proceedings before the expiry of that period;
(b) To waive the requirement to convene the meeting of creditors by the inquiry officer; or
(c) To liquidate the company or carry out the restructuring of the company.

Where the Court considers it reasonable to make any order other than that mentioned in Sub-section (1) or (3), it may also make such order.

3. RESTRUCTURING SCHEME

Preparation of Restructuring Program [Sec. 23]

Where the Court makes an order to restructure any company pursuant to Sub-section (2) of Section 22, the restructuring manager shall prepare a restructuring scheme of the company inwriting. Such scheme shall contain the following programs:

(a) To capitalize the debt of the company and alter the capital structure;
(b) To pay the claims of creditors by selling any portion of the assets of the company;
(c) To change the nature of claims of creditors of the company and issue securities for the same;
(d) To get the creditors of the company to participate in capital investment by issuing shares in consideration for their claims;
(e) To amalgamate the company with any other company;
(f) To change the management of the company;or
(g) To do any such other act which the Court considers appropriate to restructure the company.

Meeting of Creditors [Sec. 24]

The restructuring manager appointed by order of the Court to make restructuring of the company pursuant to Subsection (2) of Section 22 shall give a notice, complying with the requirements set forth in sub- sections (2) and (3) of Section 21, to all creditors to submit their respective claims, along with their respective proofs and evidences, not later than 15 days after the manager has commenced the business, and such notice shall be published in a daily newspaper of national circulation at least two times; and such notice may also be put on the website. All creditors who have any kinds of credit claims against the company shall submit to the restructuring manager statements of credit claims with or without security, along with evidence substantiating such claims no later than fifteen days after the issuance of such notice. Then, no later than fifteen days after the receipt of statements of the claims, the restructuring manager shall call a meeting of creditors, by fulfilling the requirements set forth in sub- sections (2) and (3) of Section 21. In calling such meeting, a copy of the restructuring program shall be sent along with that notice. The restructuring manager shall chair such meeting. The meeting of creditors may be conducted and adjourned as per necessity. Provided that, without the order of Court, such meeting shall not be adjourned in a manner that it exceeds the restructuring period. The directors of the company may attend the meeting of creditors and answer the questions raised by the creditors in relation to the business and financial situation of thecompany. The meeting of creditors called in the meeting shall discuss the details of restructuring program presented by the restructuring manager and adopt a resolution on any of the following matters, subject to Sub-section (7) of Section 21:

(a) To adopt, with or without amendment, the proposal on restructuring submitted by the restructuring manager, or
(b) To immediately liquate the company without accepting the resolution referred to in Clause (a).

However, such the secured creditor shall not be entitled to vote. The restructuring program adopted and thus approved or the resolution adopted to reject the program and liquidate the company shall be submitted to the Court for approval; and if the Court issues order approving that resolution, it shall be implemented.

Report by Restructuring Manager (Sec. 25)

(1) The restructuring manager shall, within the period of restructuring, submit to the Court a report, accompanied by the transactions, assets and financial situation of the company and its restructuring program, if any proposed.
(2) The report referred to in Sub-section (1) shall, where a restructuring program is proposed, state the following matters in relation to such program:
    (a) Summary and analysis of the proposed program;
    (b) Details of effects likely to be caused to the creditors of the company from the implementation of the proposed program;
    (c) A comparison between the consideration and effects that would have been available to the creditors if the company had been liquidated immediately and the consideration and effects that may be available to the creditors on the implementation of the restructuring program; and
    (d) Opinion and description, accompanied by the finding of the restructuring manager that the company would not be insolvent if the restructuring program was implemented.

(3) There shall be no formal form and structure of a restructuring program prepared pursuant to Sub-section (1), except what is set forth below:
   (a) All details of the program to be implemented by the company in the future and written details of the relevant proposal;
   (b) Details of the matter that the creditors of company will get more benefits if the company is not liquidated immediately but restructured and program is implemented;
   (c) Details of the matter that no portion of the proposed program is illegal or prohibited by the laws in force;
   (d) Details that if the program is implemented, the company will be rescued from insolvency or will not become insolvent.

(4) The program prepared pursuant to this Section shall also contain details of payment of expenses incurred during the inquiry period of insolvency proceedings or the restructuring period and of the remuneration of the inquiry officer or the restructuring manager.

Failure of Restructuring Plan [Sec. 26]

Where it is not possible to submit the details of the restructuring program of the company to the Court within the restructuring period, the restructuring manager shall make an application, accompanied by the reasons, to the Court. The Court may, if it considers e reasonable, invalidate the order to make restructuring and issue an order to liquidate the company.

Objection to Restructuring Plan [Sec. 27]

(1) A creditor who has not agreed with the proposal of restructuring program approved pursuant to Sub-section (7) of Section 24 may make an application of claim and objection within seven days, setting out the following grounds and reasons:
   (a) The restructuring program approved by a majority in the meeting of creditors is not in the interest of the creditors other than the secured creditors;
   (b) A serious irregularity has been committed in calling or conducting the meeting of Creditors, and the program approved by that meeting is not in the interest of the creditors other than the secured creditors;
   (c) False or misleading information has been given or material information has been concealed in relation to the company or its restructuring program.

(2) Where an application is made referred to in Sub-section (1), the Court shall order the company and the restructuring manager to submit written statements in relation thereto within a period of seven days.

(3) On receipt of written statements referred to in Sub-section (2) or on the expiration of the period for the submission of such written statements, the Court shall hear the application referred to in Sub-section (1) and may, if the application is found to be based on reasonable grounds, invalidate the effectiveness of the resolution on the restructuring program adopted in the meeting of creditors.

(4) If the Court invalidates the effectiveness of the resolution adopted at the meeting of creditors and approved pursuant to Sub-section (3), the Court shall issue order to liquidate the company immediately.

(5) Information of the order issued pursuant to Sub-section (3) or (4) shall be given to the concerned company and the restructuring manager.

Order For Restructuring & its Effect [Sec. 28]

If the Court issues an order to approve the restructuring program adopted by the meeting of creditors pursuant to Sub-section (9) of Section 24, the program shall be binding on all creditors of the company, directors and shareholders of the company, other than the secured creditors of the company; and the restructuring period shall end on that date.

Position of Secured Creditors (Sec. 29)

(1) No restructuring program adopted by a meeting of creditors and approved by the Court pursuant to this Chapter shall, except on the following condition, prevent the secured creditors from executing or otherwise dealing with the security he holds:
   (a) Where the secured creditor votes in favor of the restructuring program or other wise gives his or her consent that such program will be acceptable to him or her; or
   (b) Where the Court orders that that program shall be binding on the secured creditors.

(2) The Court may, if it is satisfied with the following matters, issue an order referred to in Clause (b) of Sub-section(1):
   (a) Where the secured creditor executes the security that he or she has taken, it may substantially prejudice the achievements to be made from the implementation of the restructuring program;
   (b) Where such program adequately protects the security and the right of the secured creditor to the security.

Not to Affect Certain Persons [Sec. 30]

No restructuring program adopted by a meeting of creditors and approved by the Court pursuant to this Chapter shall, except on the following conditions, prevent the owner of any property used or possessed or owned by the company or the lessor of such property if it has been leased from executing the rights to such property or returning the same:

   (a) Where the owner or lessor of such property votes in favor of such program or otherwise gives his or her consent in writing that such program will be acceptable to him or her; or
   (b) Where the Court orders that the program shall be binding to the owner or lessor of such property.

The Court may, if it is satisfied with the following matters, issue order referred to in Clause (b) of Sub-section (1):

   (a) Where the owner or lessor of such property gets back that property, it may substantially prejudice the achievements to be made from the implementation of the restructuring program;
   (b) Where such restructuring program adequately protects that property and the right of the owner or lessor of such property.

Functions, Powers & Duties of Restructuring Manager: (Sec. 31)

(1) The restructuring manager shall operate the company during the currency of the restructuring period.
(2) In operating the company pursuant to Sub-section (1), the manager may exercise the following powers:
   (a) Management and control of the business, properties and transactions of the company;
   (b) Termination, sale and disposal of any business or property of the company;
   (c) Doing or exercising any such act or power that the company or its officer may do or exercise.
(3) In exercising the powers referred to in Sub-section (2), the restructuring manager shall have power to inspect all books of account, ledgers, records, accounts and documents of the company.
(4) In doing or exercising any act or power set forth in this Section, the restructuring manager shall act in the capacity of an agent of the company.
(5) If so sought by the restructuring manager, the director and other officer of the company shall provide any kind of such assistance as may be necessary for the management and control of the company.
(6) No director and officer of the company shall, except with written direction of the restructuring manager, exercise any power or do any act of the company in capacity of the director or officer of the company.
(7) The director of the company shall provide such information about the company and its business, property and transaction to the restructuring manager as sought by the restructuring manager.

Where, while acting as the manager of the company, the restructuring manager considers any amount to be necessary to keep on running the company or operate the business and transaction of the company, he or she may borrow loan with or without furnishing the company‘s property assecurity. The amount of loan borrowed and terms thereof shall be as set forth in Section17.
It may be noted where the Court orders liquidation, then the directors cease to hold office on the pronouncement of such order. But in the case of restructuring, they continue in office unless the restructuring manager applies to the Court for removal with proper reason and the court orders their removal.

Implementation of Restructuring Program[Sec. 34]

Where as per the agreement of creditors, the restructuring program provides for the remission or alteration in the terms of any loan or any portion of the loan not secured, such remission or alteration may be made in accordance with that program.

The company shall be responsible for implementing the restructuring program adopted by the meeting of creditors and approved by the Court pursuant to this Chapter. The Court shall designate the restructuring manager for the supervision and management of the implementation of the program.

The company means the Board of Directors of the Company and they should take suitable action to implement the restructuring program.

Alteration in and Amendment to Restructuring Program [Sec. 35]

Where it appears that the restructuring program cannot be implemented wholly or partly at the time of implementation of that program but that program can be implemented if it is altered or amended, the restructuring manager shall call a meeting of creditors in order to alter or amend that program.Where the meeting called pursuant to Sub-section (1) adopts a resolution altering or amending the program, it shall be submitted to the Court for approval. Where it is reasonable to approve the program submitted pursuant to Sub-section (2) for the interest of creditors, the Court may order the alteration or amendment to that effect. The program approved pursuant to Sub-section (3) shall be implemented as per such alteration or amendment.

Termination of Restructuring Program (Sec. 36)

Where the company has already implemented the restructuring program or the Court, on application by the restructuring manager, makes an order to terminate the program because of the company's failure to implement it, such program shall terminate. Where the Court issues an order to terminate the restructuring program because of the company's failure to implement it pursuant to above, it shall also issue an order to liquidate such company.

4. LIQUIDATION OF COMPANY

Court's Order to Commence Liquidation Proceedings [Sec. 37]

Where the Court makes an order to liquidate a company pursuant to this Act, the Court shall make an order appointing one person as the liquidator, from amongst the persons who are entitled to carry on insolvency practice at the time of making of such order.

Following the making of order as above, the liquidation proceedings of the company shall be deemed to have commenced. Immediately, the directors cease to hold office in the company. But in the restructuring program approved by the Court, the directors continue in office to implement the restructuring program, unless they are removed by the order of the court.

Consequences on the Commencement of Liquidation Proceedings [Sec. 38]

(1) On the commencement of the liquidation proceedings of any company, the following provisions shall govern the following matters in relation to such company:
   (a) Where the director and officer of the company are relieved of office, the liquidator shall exercise all such powers as may be exercisable by the director and officer of the company in relation to the management of that company;
   (b) The liquidator shall take into his or her custody and under his or her control all assets, accounts and books of account of the company, except the properties in possession of secured creditors;
   (c) Except as otherwise ordered by the liquidator, the service of all employees appointed by the company shall terminate.

(2) The provision relating to *ipso facto* suspension set forth in Section 19 shall, except for the following matter, apply during the period of currency of liquidation proceedings:
   (a) Implementation of the right of secured creditors to execute pursuant to this Act; or

(b) Implementation of the right of the lessor of any property leased to the company to redeem the property pursuant to this Act.

Conversion of Liquidation of Company into Restructuring Program [Sec. 39]

(1) Where, based on the study and examination of the business and assets of the company, nature of the goods or services to be produced by the company and market potentiality thereof, the liquidator thinks that the restructuring program of the company can be adopted by a meeting of creditors and approved, the liquidator may make an application, accompanied by the reasons, to the Court for an order to keep pending the order on liquidation of company issued by the Court pursuant to this Act for a certain period of time and to implement the restructuring program pursuant to this Act.
(2) Where the Court is satisfied with the contents of the application received pursuant to Sub-section (1), it may issue an order to suspend the order on liquidation of a company issued previously for any certain period of time and implement the restructuring program.
(3) Where an order is issued pursuant to Sub-section (2), the order shall be implemented pursuant to this Act.

It is not clear whether the directors and officers ceasing to hold office on the passing of order of liquidation will resume the office of directors and officers on the order for restructuring. But unless they are reinstated, the liquidator will be the restructuring manager and will be the company and his inability to implement the program will be the inability of the company to implement the program and he cannot complain to the Court that the company could not implement the program rather that he could not implement the program under Sec. 36(1)

Functions, Duties and Powers of Liquidator [Sec. 40]

(1) The functions, duties and powers of the liquidator in addition to the other provisions set forth in this Act shall be as follows:
   (a) To institute or defend any case or legal action on behalf of the company;
   (b) To appoint employees to assist in the discharge of his or her functions;
   (c) Where any installment on any share of the company is due, to make a call on the shareholder for payment of such installment;
   (d) To do and execute, or cause to be done and executed, all such acts and deeds or documents as required to be done and executed on behalf of the company and in the name of the company and use the seal of the company for that purpose;
   (e) To borrow loans against security of the assets of the company;
   (f) Where the liquidator considers that the sale and disposal of any property or termination of any contract or liability will render benefits to the company, to sell and dispose of such property or terminate such contract or liability;
   (g) To enter into compromise with any creditor of the company or any person who claims to be a creditor of the company in relation to the claim made by such creditor or person;
   (h) To enter into compromise with any person against whom the company may make a claim in relation to any loan, liability or any other claim;
   (i) To sell the assets of the company and distribute the proceeds of such sale pursuant to this Act; and

(j) To perform, or cause to be performed, all such other acts as may be necessary to liquidate the company.

(2) It shall be the duty of the liquidator to perform the following functions, in addition to those set forth in sub-section(1):
   (a) To collect, protect and sell the assets of the company;
   (b) To examine the business and financial situation of the company;
   (c) To accept debt claim of any creditor subject to Chapter-6;
   (d) To distribute the proceeds of sale of the assets of the company subject to the order of priority determined for the payment of liability pursuant to this Act;
   (e) To call and conduct the meeting of creditors;
   (f) To prepare a report on his or her acts and actions and present it to the Court and the Office;
   (g) To facilitate the cancellation of registration of the company;
   (h) To examine or inquire into whether any director or employee or shareholder of the company or any person has committed any fraud, cheating or deception against the company or its creditors and institute necessary legal action against such person.

(3) In addition to the functions, duties and powers set forth in Sub-section (1) or (2), the liquidator may also perform other functions such as to get back any property of the company if such property is used by any person or to institute legal action to get back such property or amount involved in a void transaction. However, the liquidator shall not be entitled to make such expenses as may not be payable from the assets of the company.

(4) Even though the company does not have adequate amount to pay necessary expenses or remuneration to the liquidator for the exercise of the powers or performance of the duties set forth in Sub-section (1), (2) or (3) the liquidator shall exercise such powers and perform such duties.

(5) Where the liquidator faces any difficulty with the exercise of any power or the performance of any duty pursuant to this Chapter, the liquidator may make an application to the Court for the removal of such difficulty; and where an application is so made, the Court may, if it holds the application to be reasonable, remove the difficulty.

Money to be Lent by Creditor [Sec. 41]

(1) Where any act to be done by any company which has become insolvent may render or yield benefit or advantage to the creditors, any creditor of such company may advance money to the liquidator to do such act.

(2) Any amount borrowed pursuant to Sub-section (1) shall be paid from the amount received from such act.

(3) Any creditor may make an application to the Court for any order for making payment of a debt claim accepted by the company from the amount received pursuant to Sub-section(1).

(4) Where an application is made pursuant to Sub-section (3), the Court may, if it considers reasonable that such loan can be repaid from the amount referred to in Sub-section (1), make an order for that purpose.

It may be noted that only when the act to be done by the company through the liquidator could yield benefit or advantage to the creditors, then the creditor can advance money to the liquidator for meeting the expenses of carrying out the Accounts.

Example: Company 'P' has taken a loan of Rs.2,00,000 plus interest amounting to Rs.1,00,000 by mortgaging a property whose present market value is Rs.20,00,000, it will be a benefit to the creditors, if the said property is released by paying Rs.3,00,000, then Rs.17 lakhs will come to the benefit of the creditors. If creditors Y advances Rs. 3,00,000 to redeem the property, he can claim to be repaid his loan of Rs. 3,00,000 plus interest out of the proceeds of the redeemed property in priority to other creditors under this Section for which he must put a claim before the Court seeking an order for payment of his dues from the proceeds of the redeemed property by the liquidator, Balance Rs.17,00,000 will go to the general benefit of the creditors.

Submission of Report by Liquidator [Sec. 42]

The liquidator shall prepare a progress report on the proceedings carried out in relation to the company and submit it to the Court and the Office no later than three months after the date of his or her appointment. The report shall state the following matters, in addition to other matters:

(a) The amount of issued capital of the company, capital that the shareholders have undertaken to subscribe and paid-up capital;
(b) Estimated value of the assets and liabilities of the company;
(c) Opinion of the liquidator in relation to the reason for financial failure of the company;
(d) Opinion of the liquidator on the need to further examine or inquire into the promotion, incorporation of the company or the affairs of the company and its directors and shareholders;
(e) Such other necessary matters as the liquidator considers appropriate.

Calling Meeting of Creditors [Sec. 43]

The liquidator shall, prior to preparing his or her report pursuant to Section 42 and thereafter from time to time as per necessity, call a meeting of creditors of thecompany.A meeting of creditors shall be called pursuant to Sub-section (1) by fulfilling the requirements set forth in sub-sections (2) and (3) of Section 21i.e. by giving at least seven days notice of the meeting by post or telex or facsimile or e-mail other mean of electronic communications and publishing a notice two times in the national level newspaper.The liquidator shall chair the meeting ofcreditors.The provisions of Section 24 applying to the meeting of creditors shall apply, *mutatis mutandis*, to the other matters relating to the meeting of creditors.

Debt Claim (Sec.45)

The liquidator shall give a notice with the time limit of fifteen days to all creditors of the company which has become insolvent to submit their respective debt claims in the prescribedformat.The notice such given shall be published at least twice in a newspaper of nationalcirculation.The liquidator may reject any claims of the creditors who have not made claim within the afore stated time limit. However, where any creditor makes an application, accompanied by the reason for failure to submit his or her claim within that time limit, to the

liquidator, the liquidator may accept such claim if the contents of such application are found reasonable.

Power of the Court to Give Order (Sec. 46)

Notwithstanding anything contained elsewhere in this Chapter, the Court may at any time issue the following order in respect of any company which is undergoing liquidation proceedings:

(a) To suspend or terminate the liquidation of the company;
(b) To require to hand over the assets of the company to the liquidator;
(c) To pay any call made for payment of installment;
(d) Where there is a doubt that any person is possessing or using any property of the company, to stop such possession or use;or
(e) To arrest any person who causes any hindrance in or obstruction to the performance of functions or duties or the exercise of powers by the liquidators.

Cancellation of Registration of Company (Sec. 47)

Any liquidator appointed to liquidate any company pursuant to this Chapter shall, after completion of the liquidation proceedings of the company, cancel the registration of the company at the Office of Company Registrar by following the procedures determined by this Act or by other laws inforce.

Submission and Acceptance of Claims (Sec. 48)

A creditor of the company which has become insolvent shall submit a claim for the loan due and outstanding or payable by such company to him or her, in the prescribed format within the time limit specified by the restructuring manager or liquidator. While submitting such claim, the creditor shall also submit the proof and evidence substantiating such claim, if any, where the restructuring manager or liquidator demands such proof and evidence.The restructuring manager or liquidator after examining such submitted particulars, may accept or reject such claim wholly or partly. Where the restructuring manager or liquidator rejects such claim wholly or partly, the manager or liquidator shall give written information thereof, accompanied by the reasons for such rejection, to the creditor submitting the claim not later than seven days from the date of receipt of the claim. The creditor who is not satisfied with such information received may make an application to the Appellate Court for review not later than fifteen days of receiving such information. Even a foreign creditor who has lent money to the company pursuant to the laws in force may, if he or she has any debt claim against the company, submit a claim pursuant to this Section.

Unquantified Claim and Contingent Liability (Sec. 50)

(1) Except as set forth in Section 48, any claim on any liability of an undetermined value which has resulted from any loss caused by the company, or from any compensation to be paid by the company to anyone as a result of its failure to comply with any contract or for having violated any contract, or from any other action which creates a civil obligation, or any claim on any contingent obligation of the company whose value is yet to be determined but which has resulted from the failure of a debtor to fulfill any obligation for which the company has

provided guarantee under any guarantee agreement may be presented pursuant to Sub-section (1) of Section 48.

(2) Where a claim is received pursuant to Sub-section (1), the restructuring manager or liquidator shall either accept or reject such claim pursuant to Sub-section (3) of Section 48 and give a notice thereof pursuant to Sub-section (4) of the said Section.

(3) Where such claim is accepted pursuant to Sub-section (2), the restructuring manager or liquidator shall also determine the estimated value of such claim.

(4) Notwithstanding anything contained in Sub-section (3), the restructuring manager or liquidator may make an application to the Court to have the value of such claim determined; and where a petition is so made, the Court shall determine the estimated value of such claim.

(5) Any person who is not satisfied with the decision to reject the claim pursuant to Sub-section (2) or with the value of such claim determined pursuant to Sub-section (3) may make a complaint to the Court within fifteen days from the date of receipt of the notice there of.

Adjustment of Debts (Sec. 53)

(1) Where there has been any other transaction between a company which has become insolvent and any creditor who makes a debt claim against the company, the debt or such debt claim or transaction shall be adjusted as follows:
   (a) To determine the amount due to be paid by one party to the other party;
   (b) To deduct the amount payable by one party to the other party from the amount determined pursuant to Clause (a);
   (c) To fix only the amount that remains after making deduction pursuant to Clause (b) as the claim of debt payable by the company.

(2) Notwithstanding anything contained in Sub-section (1), any person who has supplied to or obtained a debt from the company when that person has knowledge or had a reasonable knowledge that the company has become insolvent shall not be entitled to make a claim to have the amount due to be paid to that person by the company deducted from the amount payable by that person to the company.

Explanation: For the purposes of this Section, the expression "company which has become insolvent" shall mean a company in relation to which an application has been filed in the Court for the restructuring or liquidation of that company.

Rights of Secured Creditors (Sec. 54)

A secured creditor may make a debt claim against the company at any time; and the restructuring manager or liquidator may accept or reject that claim pursuant to Sub-section (3) of Section 48. Such amount to be claimed shall be limited to the difference between the amount received from the property kept as security according to its market value and the amount payable by the company to the secured creditor. Where there arises a dispute between the secured creditor and the company which has become insolvent in relation to the difference between the value of the secured property and the amount outstanding and such payable, a party who is not satisfied with that matter may make an application to the Court; and the Court may examine the application so made and determine the difference amount.

Claim of Shareholder [Sec. 55]

Where any creditor who is also a shareholder of a company which has become insolvent makes a claim against the company, and where that creditor has not paid any amount due on his or her share and where the time has already matured to pay such amount or there may arise a situation requiring him or her to pay the same, his or her claim up to the extent of the amount likely to be so paid shall not be accepted.

Where a debt claim has been made by a person making a claim against the company which has become insolvent is accepted pursuant to this Chapter, that person shall acquire the status of creditor. A person who acquires the status of creditor as such, shall acquire the right to participate in a meeting of creditors, exercise the voting right to the extent of the accepted debt claim and receive payment of the amount of debt under this Act.

Priority of Settlement of Claims (Sec. 57)

(1) While settling the liabilities of a company which is being liquidated under this Act, the liquidator shall make payment of liabilities from the available funds according to the following order of priority:
   (a) All expenses and remuneration associated with the functions discharged by the interim administrator appointed pursuant to Sub-section (4) of Section 11;
   (b) Other amounts to be settled pursuant to Chapter-2;
   (c) All expenses and remuneration associated with the functions discharged by the inquiry officer appointed pursuant to sub- sections (3) and (4) of Section 10;
   (d) All expenses and remuneration associated with the functions discharged by the restructuring manager appointed pursuant to Sub-section (2) of Section 22;
   (e) All debts of the company borrowed during the period of investigation of the insolvency proceedings;
   (f) All debts of the company borrowed during the period of the restructuring program of the company;
   (g) All expenses and remuneration associated with the functions discharged by the liquidator appointed pursuant to Sub-section of Section 37;
   (h) Wages and remuneration due and payable to the workers or employees of the company at the time of the issue of the order under this Act to liquidate or restructure the company; However, no director of the company shall be entitled to such amount.
   (i) Amounts payable to the workers or employees of the company in consideration of home leave, sick leave, gratuity and employee provident fund, if any, at the time of the issue of the order under this Act to liquidate or restructure the company; Provided that no director of the company shall be entitled to such amount.
   (j) All other amounts in consideration of debt claims accepted by the liquidator.

(2) Every liability falling in the order of priority referred to in Subsection (1) shall be treated equally; and all liabilities falling in such order shall be settled fully. Provided that if such liabilities cannot be settled fully, they shall be settled proportionately.

(3) Where any liability of the company is insured, the amount receivable under such insurance contract shall be paid to that person who is entitled to it.

(4) Where the liabilities mentioned in Sub-section (1), (2) or (3) are settled fully, the surplus shall be used by the liquidator to pay interest payable on debts from the date of the order issued to liquidate or restructure the company to the date of acceptance of the debt claim. The amount remaining after such payment shall be distributed among the preference shareholders, and the remaining amount shall be distributed among the other shareholders proportionately.

While settling the liabilities of the creditors pursuant to this Chapter, the liquidator may do so at one time or at various different times.

5. VOIDABLE TRANSACTION

Voidable Transactions [Sec. 59]

(1) Where any company has become insolvent, the following transactions shall be void:

(a) Preferential transactions carried on within six months immediately preceding the commencement of the insolvency proceedings or within the period of six months after the commencement of the proceedings;

(b) Preferential transactions carried on with the associated persons of the company in advance of one year immediately preceding the commencement of the insolvency proceedings or within the period of one year after the commencement of the proceedings;

Explanation: For the purposes of Clauses (a) and (b), the expression "preferential transactions" shall mean any transactions done or entered into with a provision for payment of amount that exceeds the payment which any creditor of the company other than a secured creditor would have been entitled to get if the creditor had made a claim against the company at the time of its liquidation.

(c) Any under valued transactions that have been carried on within one year immediately preceding the commencement of the insolvency proceedings or within the period of one year after the commencement of the proceedings and the company has become insolvent as a consequence of such transaction or other under-valued transactions carried on after the commencement of the insolvency proceedings;

Explanation: For the purposes of this Clause, the expression "under-valued transactions" shall mean any transactions in relation to which the company has received a value that is lower than the prevailing market value or has not received any value at all for any consideration given by the company to the other party to the transactions.

(d) All fraudulent transactions carried on within two years immediately preceding the commencement of the insolvency proceedings or within the period of two years after the commencement of the proceedings;

Explanation: For the purposes of this Clause, the expression "fraudulent transactions" shall mean any transactions carried on, in relation to any assets of the company, with ulterior motive to cheat the creditors of the company or delay making payments to them or prejudice the rights of the creditors.

(2) The liquidator shall make an application to the Court to have the transactions referred to in Sub-section (1) declared void.
(3) While making an application pursuant to Sub-section (2), the liquidator shall prove that the company was insolvent when such transactions were carried on or the company has become insolvent by the reason of such transactions.
(4) Where any associated person of the company is found involved in the proceedings carried out in relation to any Voidable transactions, it shall be presumed that the company was insolvent when such transactions were carried on or the company has become insolvent by the reason of such transactions.

The students must note that there are four types of voidable transactions viz

1. Preferential transaction carried out **within six months** either immediately before or after the commencement of liquidation proceedings
2. Preferential transaction carried out with associated persons **within one year** either immediately before or after the commencement of liquidation proceedings
3. Any under valued transactions carried out **within one yea**r either immediately before or after the commencement of liquidation proceedings
4. All fraudulent transactions carried on **within two years** either immediately before or after the commencement of liquidation proceedings.

Defense in Case of Voidable Transaction [Sec. 60]

The associated person may prove the following matters in his or her defense:
(a) That the company was not insolvent when the transactions were carried on;
(b) That he or she has not derived any benefit from the transactions;
(c) That the company was insolvent when any benefit was derived from the transactions or there was no reasonable reason to suspect that the company might become insolvent by the reason of the transactions.

Powers of the Court in Relations to Voidable Transactions[Sec. 61]

Where the Court is satisfied that any transaction is voidable, the Court may issue orders as follows:
(a) To order the concerned person to pay to the liquidator some or all of the amounts paid by the company in connection with such transaction;
(b) To order the concerned person to hand over to the liquidator the asset so transacted or an amount equivalent thereto;
(c) To order that the debt obtained by the company through such transaction, or the collateral or guarantee furnished by the company for that debt be fully or partly remitted or released;
(d) To order that any remission or assignment made or agreement entered into between the company and any other person in consequence of the voidable transaction be void, in operative orunen forceable.

If any other additional order is required to be given to enforce the order issued as above, the Court may issue such order.

Amount Paid in Consideration of Preferential Transaction [Sec. 62]

Any creditor who pays any amount to the liquidator in relation to any preferential transaction made with the company, as a secured creditor according to the order of the Court or for any other reason, may make a claim for that amount as a debt claim against the company in liquidation.

But his debt claim for moneys advanced after the liquidation proceedings started, may not be paid in full if the proceeds of the assets sold is not sufficient to pay all the debt claims in full. But moneys borrowed during investigation proceedings or restructuring program implementation will rank in priority as mentioned in Sec.57.

6. MISCELLANEOUS

Regulation of Insolvency Practice

No person shall operate insolvency practice without obtaining a license from the Office pursuant to this Act. Any person who has not obtained the license shall not be appointed as the inquiry officer, restructuring manager or liquidator in the course of carrying out insolvency proceedings under this Act. Where any person other than a licensee is appointed as the inquiry officer, restructuring manager or liquidator, such appointment shall *ipso facto* bevoid.

A person who is desirous of obtaining a license for insolvency practitioner shall make an application, along with the prescribed fee, to the Office in the prescribed format. The applicant shall meet the following conditions:

(a) Have completed the age of thirty five years;
(b) Being a member of the prescribed professional association;
(c) Having acquired at least bachelor's degree in commercial law, commerce, management, accounts or any other prescribed subject from a recognized university;
(d) Having abode in the State of Nepal;
(e) Being competent to carry on insolvency practice under this Act.

On receipt of an application, the Office shall, if it considers appropriate to issue a license to carry on the insolvency practice, issue the license in the prescribed format. The license shall be renewed as prescribed.

The remuneration of the inquiry officer, restructuring manager or liquidator appointed under this Act shall be as fixed by the meeting of creditors from time totime. Where remuneration cannot be fixed as such, the Court may specify such remuneration on the basis of the report of the Office.

Insolvency Administration Office[Sec. 65]

After the commencement of this Act, the Government of Nepal shall establish an Insolvency Administration Office by notification in the Nepal Gazette. Pending the establishment of such Office, the Government of Nepal may designate any of its offices to perform the functions of the Insolvency Administration Office.The Office established pursuant to Sub-section (1) shall perform the following functions:

(a) To administer insolvency practice;
(b) To register insolvency practitioners, issue licenses to them, and renew such licenses;
(c) To carry out general supervision of the management of companies which have become insolvent;
(d) To conduct investigations of the code of conduct of office required to be observed by insolvency practitioners;
(e) To maintain separate records of each company which has become insolvent;and
(f) To perform such other functions as prescribed.

Suspension or Cancellation of License [Sec. 66]

Where a complaint is made that any insolvency practitioner licensed person has not performed the functions as set forth in the license or the Office makes a report to that effect or the Court itself so considers, then the Court may institute action in this respect and issue an order suspending or canceling the license of such person. Prior to issuing any order, such person shall be provided with an opportunity to defend himself or herself.

The Court may issue the order referred above on the following grounds:

(a) Where the licensee does any act that is prohibited under this Act;
(b) Where the licensee does any acts required to be done under this Act in a reckless manner or fails to do such acts in a proper manner;
(c) Where the person licensed to practice insolvency himself or herself becomes insolvent;
(d) Where the person licensed to practice insolvency is convicted by a court of corruption, cheating, forgery or fraud.

To Keep Separate Account [Sec. 69]

(1) The restructuring manager or liquidator appointed under this Act shall, while conducting insolvency proceedings under this Act, open and operate a separate bank account of every company to which he or she has been appointed.
(2) All amounts received by him/her shall be paid into the bank account opened pursuant to sub-section (1).
(3) Any amount balance in the bank account opened pursuant to Sub- section (1) shall be invested only in the prescribed fields.
(4) In addition to those mentioned in Sub-section (1), the restructuring manager or liquidator shall maintain other accounts and books of accounts clearly reflecting the full and actual affairs of the insolvency proceedings of every company which has become insolvent and submit the statements of such accounts and books to the Court or the Office, as per necessity.
(5) The restructuring manager or liquidator shall, on performance of his or her duties, shall have the accounts and books of accounts, as well as the statements thereof, maintained by him or her pursuant to this Section audited in accordance with the laws and hand them over the same to the Office.

Removal of Liquidation or Restructuring Administrator [Sec. 71]

Where a complaint is made that a restructuring manager or liquidator appointed pursuant to this Act has failed to work in accordance with this Act while carrying out the insolvency proceedings

of any company assigned to him or her or where his or her conduct is found to be contrary to this Act, the Court may issue an order to remove him or her. The concerned person shall not be deprived of an opportunity to defend himself or herself, prior to issuing the order.

Liquidator and Restructuring administrator appointed under the Act are answerable to the Court and Insolvency Administration office and should reply without delay any queries asked by the Court or the office.

Offences & Punishment [Sec. 72]

(1) A person shall be deemed to have committed an offense under this Act if he or she commits, or causes the commission of, any of the following acts:
   (a) Where a person holding the office of director of a company does not submit to the Court a report on the financial condition and transaction of the company in the prescribed format under Section 16;
   (b) Where any person acts as an insolvency practitioner without obtaining a license from the Office pursuant to this Act;
   (c) Where the director of a company deliberately conceals the fact that the company has become insolvent or is going to become insolvent;
   (d) Where an insolvency practitioner fails to discharge any such function in good faith as required to be discharged by him or her under this Act;or
   (e) Where any director or employee or shareholder or other person of a company commits any act of fraud or forgery against, or cheats or misleads, the company or its creditors.

(2) The Court may punish any director who commits the offense referred to in Clause (a) of Sub-section (1) with a fine not exceeding fifty thousand rupees.

(3) The Court may punish any person who commits the offense referred to in Clause (b) of Sub-section (1) with a fine from ten thousand rupees to fifty thousand rupees.

(4) Any director who commits the offense referred to in Clause (c) of Sub- section (1) shall be punished with a fine not exceeding two hundred thousand rupees; and the director shall pay such fine personally.

(5) Where any company, creditor or concerned party suffers any loss as a result of the failure of an insolvency practitioner to discharge such function in good faith as required to be discharged by him or her as mentioned in Clause (d) of Sub-section (1), compensation for such loss shall be recovered from such practitioner, and he or she may also be punished with a fine not exceeding five hundred thousand rupees.

(6) The Court may punish any director, employee, shareholder or other person who commits the offense referred to in Clause (e) ofSubsection (1) with imprisonment for a term from one year to two years and with a fine from one hundred thousand rupees to five hundred thousand rupees; and the amount involved in the offense shall also be recovered from such offender.

Filing of Case against the Offence [Sec. 73]

Where any person appears to have committed any of the offenses referred to in Section 72, the liquidator, Office or concerned party may file a case, along with the grounds for the same, in the concerned court.

CHAPTER- 13

ASSET (MONEY) LAUNDERING PREVENTION ACT, 2064

1. INTRODUCTION

The goal of a large number of criminal acts is to generate a profit for the individual or group that carries out the act. Asset (money) laundering is the processing of criminal proceeds to disguise their illegal origin. This process is of critical importance, as it enables the criminal to enjoy these profits without jeopardizing their source. It is an illegal activity carried out by criminals which occurs outside of the normal range of economic and financial statistic.

In response to mounting concern over money laundering, the Financial Action Task Force (FATF) was established by the G-7 Summit that was held in Paris in 1989. Recognizing 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. The FATF currently comprises 37 member jurisdictions and 2 regional organisations, representing most major financial centres in all parts of the globe. Asia/Pacific Group (APG) is one of the Associate members. Nepal is a member of APG.

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. Starting with its own members, the FATF monitors countries' progress in implementing the FATF Recommendations; reviews money laundering and terrorist financing techniques and counter- measures; and, promotes the adoption and implementation of the FATF Recommendations globally.

An assessment by Asia/Pacific Group on Money Laundering, an associate member of FATF, in 2005 had found significant deficiencies in Nepal‘s legislation and anti-money laundering infrastructure. Nepal did not fully complied any of the 49 standards set by FATF, raising doubts over Nepal‘s ability to control financing to criminal activities.

The last Mutual Evaluation Report relating to the implementation of anti-money laundering and counter-terrorist financing standards in Nepal was undertaken by the Financial Action Task Force (FATF) in 2011. According to that Evaluation, Nepal was deemed Compliant for 1 and Largely Compliant for 3 of the FATF 40 + 9 Recommendations. It was partially compliant or non-compliant for all 6 of the Core Recommendations. The report is based on evaluation carried by Asia/Pacific Group.

Asset Laundering Prevention Act, 2008 was enacted by Legislature- Parliament to make legal provisions for the prevention of money laundering and terrorist financing. However, it was inadequate as per FATF requirements. In 2011, Nepal made a high-level commitment to FATF regarding legislations and anti-money laundering institutional infrastructure. To fulfill this commitment the Asset Laundering Prevention Act, 2008 was first amended in 2011 and again in 2014 for the second time. Further, it was amended in 2016 and 2019. These amendments has made this Act at par with FATF requirement.

This Act is applicable all over Nepal and is applicable to any person committing the offence of money laundering or terrorist financing irrespective of whether such person is located in Nepal or outside.

In this Act, following terminologies are defined as follows:

(a) Terrorist Act: Terrorist Act means and includes following activities:

(i) Any act, which is defined as an offence by Article 2 (1) (a) of the International Convention for the Suppression of the Financing of Terrorism 1999.

(ii) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a Government or an international organization to do or to abstain from doing any act.

(iii) Any act that is an offence under the following convention to which Nepal is a party to:
   (a) Tokyo Convention on Offences and Certain Other Acts committedon Board Aircraft, 1963.
   (b) SAARC Regional Convention on Suppression of Terrorism, 1987.
   (c) Any other convention against terrorism which Nepal becomes party to, after the implementation of this Act.

(b) Terrorist (individual): Terrorist (individual) means any natural person who commits the following acts:

(i) Commits or attempts to commit terrorist acts by any means, directly or indirectly, unlawfully and will fully

(ii) Participates as an accomplice in terrorist acts,

(iii) Organizes or directs others to commit terrorist acts,or

(iv) Contributes or cooperates to group of persons acting with a common purpose of commission of terrorist acts where such contribution or cooperation is made intentionally and with the aim of furtheringthe terrorist act or with the knowledge or the intention of the group to commit a terrorist act.

(c) Terrorist organization means any organized or unorganized group or organization of terrorists that commits the following acts:

(i) Commits, or attempts to commit, terrorist acts by any means, directly or indirectly, unlawfullly and will fully,

(ii) Participates as an accomplice in terrorist acts,

(iii) Organizes or directs others to commit terrorist acts, or

(iv) Contributes or cooperates to group of persons acting with a common purpose of commission of terrorist acts where the contribution or cooperation is made intentionally and with the aim of furthering the terrorist act or with the knowledge or the intention of the group to commit a terrorist act.

(d) Politically Exposed Person means any domestic politically exposed person or official or foreign politically exposed person or official or international politically exposed person or

official. It shall also include other group of person as designated by the Government of Nepal upon the recommendation of National Coordination Committee.

(e) Corresponding Banking means the provision of banking services by one financial institution to the customer of another financial institution.

(f) Proceeds of crime means any property derived from or obtained directly or indirectly through the commission of money laundering or predicate offence and it shall also include any other property and economic advantage gained or derived from such property or any property transferred or converted into other property or advantage, in full or in part, from such property or advantage

(g) Instrumentality means any means or property used in or in connection with or intended to be used, wholly or in part, in or in connection with the commission of an offence and it shall also include any instruments.

(h) Transaction means any agreement made in order to carry out any economic or business activities and the term also means the purchase, sale, distribution, transfer or investment and possession of any assets, or any other acts as follows:

(i) Establishing business relationship,
(ii) Opening of an account,
(iii) Any deposit or collection, withdrawal, exchange or transfer of funds in any currency or instruments, payment order by electronic or other means,
(iv) Use of any type of safe deposit box (locker),
(v) Entering/establishing into any fiduciary relationship,
(vi) Any payment made or received in satisfaction, in whole or in part, of any contractual or other legal obligation,
(vii) Any payment made or received in respect of a lottery, bet or other game of chance,
(viii) Establishing or creating a legal person or legal arrangement, or
(ix) Such other act as may be designated by the Government of Nepal by publishing a notice in the Nepal Gazette.

(i) Legal Arrangement means trust (express trust) or other similar kind of legal arrangements.

(j) Legal Person means any company, corporation, proprietorship, partnership firm, cooperatives, or any other body corporate.

(k) Funds means any financial assets, economic resources, property of every kind, whether tangible or intangible, movable or immovable, physical or non- physical (corporeal or incorporeal), or the following instruments or resources, however acquired. It shall also include legal documents or instruments in any form, including electronic or any other, evidencing title to, or interest in, such property, instruments or resources:

(i) Bank credits,
(ii) Traveler's cheques,
(iii) Bank cheques,

(iv) Money orders,
(v) Shares,
(vi) Securities,
(vii) Bonds,
(viii) Drafts,
(ix) Letters of credit,
(x) Any other financial or economic resources.

(l) Designated Non-Financial Business or Profession means any person who conducts or carries on following act or business:

(i) Casinos or internet casinos,
(ii) Purchase or sale of real estate,
(iii) Dealing in prescribed precious metals or precious stones,
(iv) Notaries, other independent legal and accounting and other similar professionals when they prepare for, engage in, or carry out transactions for a client concerning any of the following activities:
  (a) Buying and selling of real estate,
  (b) Managing of client money, securities or other assets,
  (c) Management of bank, savings or securities accounts,
  (d) Organization of contribution and investment during the period of creation, operation (management) of legal persons,
  (e) Creation, registration, operation or management of legal persons or arrangements, or
  (f) Buying and selling of any business entities.
(v) Trust and company service providers which prepare for, engage in, or carry out transactions on behalf of customers in relation to any of the following services, as a business:
  (a) Acting as a formation, registration or management agent of legal persons or legal arrangement,
  (b) Acting as, or arranging for another person to act as, a partner, director or secretary of a legal person, or to hold a similar position in relation to other legal person,
  (c) Providing a registered office, or accommodation, business address or correspondence or administrative address for a legal person or legal arrangement,
  (d) Acting as, or appointing or arranging for another person to act as, a trustee of an express trust or other similar arrangement,
  (e) Acting as, or arranging for another person to act as, a nominee shareholder for another person pursuant to prevailing law,
(vi) Any other business, profession or activity as may be designated by the Government of Nepal by publishing a notice in the Nepal Gazette.

(m) Bearer Negotiable Instruments means any negotiable instruments including the monetary instruments in bearer form including traveler's cheques, cheques, promissory notes and money orders that are either in bearer form, endorsed without restriction, made out to a fictitious payee, or otherwise in such form that holder's title thereto passes upon delivery or any such instruments in incomplete form or without the name of payee or payable to anyone who holds or receives it.

(n) Beneficial owner means a natural person who, directly or indirectly, owns or controls or directs or influences a customer, an account, or the person on whose behalf a transaction is conducted, or exercises effective control over a legal person or legal arrangement or remains as an ultimate beneficiary or owner of such activities.

(o) Financial Institution means any person who conducts any of the following activities or operations for or on behalf of a customer, as a business:

(i) Acceptance of deposits and other repayable funds including from the public,
(ii) Private banking,
(iii) Any type of lending,
(iv) Financial leasing, except consumer products,
(v) Money or value transfer services, except those limiting their functions solely with passing message for transmitting funds,
(vi) Issuing and managing any means of payment namely cheque, draft, money order, debit card, credit card, including any electronic or other instrument of payment,
(vii) Financial guarantees and commitments,
(viii) Trading in following instruments:-
    (a) Money market instruments including cheques, bills, certificates of deposit, derivatives etc.,
    (b) foreign exchange,
    (c) Exchange, interest rate and any instrument of value or amount,
    (d) Transferable securities,or
    (e) Commodity future strading.
(ix) Participation in securities issues and the provision of financial services related to it,
(x) Individual and collective portfolio management,
(xi) Safekeeping and administration of cash or liquid securities on behalf of other persons,
(xii) Underwriting and placement of life insurance and other investment related insurance,
(xiii) Money and currency changing,
(xiv) Otherwise investing, administering or managing funds or money on behalf of other persons beyond clause (1) to (13) or
(xv) Executing the function as prescribed by the Government of Nepal by publishing a notice in Nepal Gazette.

(p) Foreign politically exposed person means politically exposed person who is or has been the Head of State or of government, senior politician, central member of national political party, senior government, judicial or military official, senior executives of state owned corporations of a foreign country.

(q) Shell Bank means a bank, which has no physical presence in the country in which it is incorporated, licensed or located, and which is not affiliated with a regulated financial services group that is subject to effective consolidated supervision. Presence of local agent or junior level staff does not constitute physical presence.

Offence of Money Laundering and Terrorist Financing

Asset Laundering Prevention Act, 2008 prohibits certain acts of appropriation of property which may lead to money laundering and terrorist financing. According to Section 3 of Asset Laundering Prevention Act, 2008 property cannot be laundered for following activities:

(1) No person shall commit or cause to commit in any of the following acts:-
   (a) Converting and transferring property by any means knowing or having reasonable grounds to believe that it is proceeds of crime for the purpose of concealing or disguising the illicit origin of property, or assisting any person involved in the offence for evading legal consequences of of fender.
   (b) Concealing or disguising or changing the true nature, source, location, disposition, movement or ownership of property or rights with respect to such property knowing or having reasonable grounds to believe that it is proceeds of crimes.
   (c) Acquiring, using, possessing property knowing or having reasonable grounds to believe that it is the proceeds of crime.

(2) No person shall conspire to commit, aid, abet, facilitate, counsel, attempt, associate with or participate in the commission of the acts mentioned in sub section (1).

(3) Any person who commits any act mentioned in subsection (1) or (2), commits the offence of money laundering.

This act prohibits any act of terrorist financing. It is considered an offence. Section 4 of Asset Laundering Prevention Act, 2008 says:

(1) No person shall, by any means, directly or indirectly, unlawfully and willfully, provide or collect funds with the intention that they should be used or in the knowledge that they are to or intended to be used, in whole or in part, in order to carry out a terrorist act, or by a terrorist or a terrorist organization.

(2) No person shall attempt to commit any act mentioned in sub section (1).

(3) No person shall, by any means, directly or indirectly, provide or conspire to provide material support or resources to any terrorist or terrorist organization or in order to carry out a terrorist act.

(4) No person shall undertake any of the following acts in relation to any act mentioned in subsection (1), (2) or (3):
   (a) To participate as an accomplice in such act,
   (b) To organize or direct others to commit such act,
   (c) To contribute a group of persons which commits such act or has a common purpose of committing such act or will fully promote such group of persons for furthering their criminal activities or to achieve such purpose.

(5) It shall be the offence of terrorist financing if any of the following circumstances exist in relation to any act under this section:
   (a) Even if the terrorist act does not occur or is not attempted,
   (b) Even if funds were not actually used to commit or in the attempt the terrorist act,
   (c) Even if such funds are linked or not to a specific terrorist act,
   (d) Even if the terrorist act or intended terrorist act does occur or will occur in the same State or territory or somewhere else,

(e) Even if the terrorist organization and individual terrorist is or is not located in the same State or territory where the terrorist act is intended to or occurs,
(f) Whether or not the funds are collected or provided from legitimate or illegitimate source,

(6) Any person who commits an act mentioned in sub sections(1),(2),(3),(4)or (5) shall commit the offence of terrorist financing.

It shall be an offence of terrorist financing for the purpose of this Act, if any act mentioned in sections 3 or 4 occurs in a foreign state or territory and such act is an offence under the law of that state.

2. PROVISIONS ON CUSTOMER IDENTIFICATION & TRANSACTIONS

Provisions on Customer Identification and Transactions

Reporting Entity is prohibited to establish or maintain anonymous accounts, or accounts in fictitious names or transact in such accounts or cause to do so.

No shell bank is permitted to be established or to operate in or through the territory of Nepal. Financial institution of Nepal shall not enter into or continue business relation with any financial institution or other entity that allow transaction to shell bank.

Customer Identification Details to be Required by Reporting Entity.

Reporting Entity shall accurately identify the customer and verify such identification when carrying out the following acts:

(a) Establishing business relationship,
(b) Opening an account,
(c) Carrying out occasional transactions above a threshold as may be prescribed,
(d) Carrying out wire transfers by electronic means,
(e) There is suspicious about the veracity or adequacy of previously-obtained customer identification information,
(f) There is suspicion of money laundering or terrorist financing,
(g) At any time of transaction in relation to the high risked and politically exposed person,
(h) In any other situations as prescribed by the Regulator.

Reporting entities shall receive documents as prescribed in the customer identification process. Reporting entity shall use such reliable and independent source documents, data, information for the identification and verification of the customer as per this chapter.

Reporting entity shall take following measures when undertaking the identification and verification of its customer:

(a) Understanding and obtaining information and details clarifying on the objectives, purpose and intended nature of business relationships and transactions,
(b) Obtaining name, address and date of birth including the documents as prescribed in subsection (2) where the customer is a natural person,

(c) Where the customer is a legal person or legal arrangement, understanding and verifying its ownership and control structure, and obtaining such information including the documents as prescribed in sub-section (2),
(d) When a person is establishing business relationship or conducting transaction on behalf of another customer, obtaining identification document of such person and the person working on behalf of him including evidence verifying that that such person is properly authorized to act,
(e) Obtaining other information and details regarding customer, transaction and its nature to fulfill the obligations under this chapter,
(f) Applying other measures as prescribed by the Regulator.

Following reporting entity as DNFBPs is not mandatory to take identification and verification measures of the following customer:-

(a) A casino for a customer involving in the transactions of NRs two hundred thousand or lesser in a day,
(b) A precious metal and object business for a customer involving in transactions of NRs one million or lesser in a day.

Entire liability of accurately identifying and verifying the identity of the customer pursuant to this chapter shall be of the reporting entity.

Section 7B Provides, there are special provisions prescribe by this Act for Identification of Politically Exposed Person. Those provisions are as follows:

(1) Reporting entity shall establish a risk management system to identify whether a customer, person seeking to be customer or a beneficial owner of a customer or transaction is a politically exposed person.
(2) Reporting entity, while evaluating as per subsection (1), shall adopt the following additional measures if it finds the customer or beneficial owner is either a foreign PEP or a domestically exposed person or international politically exposed persons evaluated to be of high risk due to business reason:
    (a) To obtain approval from senior management official while establishing a business relationship,
    (b) To acquire approval from senior management official to continue the business relation with an existing customer if he is identified as a politically-exposed person as per clause (a),
    (c) To take all reasonable measures to identify the source of amount/fund and property of such customer or beneficial owner,
    (d) To conduct ongoing monitoring of such customer and the business relationship,
    (e) To apply Enhanced CDD measures pursuant to section7E.
(3) Provisions stipulated in sub-sections (1) and (2) shall be applicable to the family members and associated persons of foreign PEP, or international PEP or domestic PEP identified as high risk.

Identification of Beneficial Ownership

When establishing business relationship or conducting transaction with by reporting entity, if there is any possibility of the involvement of beneficial ownership, it has to be identified and reasonable measures have to be taken to verify the identity of the beneficial owner. Reporting entity shall ascertain whether a person is acting or establishing business relationship or conducting transaction, on behalf of another person. Reporting entity, while as certaining whether a person is establishing business relation or transaction on behalf of other, shall follow the identification and verification measures as stipulated in clause (d) of sub-section (4) of section 7A of Asset Laundering Prevention Act, 2008.

The reporting entities have to do mandatory risk assessment and management while establishing any business relationship or conducting a transaction. Section 7 D of Asset Laundering Prevention Act, 2008 has following provisions for the risk assessment and management:

(1) Reporting entity shall identify and assess risks on ML and TF in accordance with its business or profession, scope, customer, products or services, transactions or delivery channel etc.
(2) Reporting entity, while conducting risk assessment pursuant to sub- section (1), shall also take into account the findings of the national and regulatory risk assessment.
(3) Reporting entity shall, while conducting risk assessment pursuant to sub-section (1), determine the level of risks by analyzing all relevant risk factors.
(4) Reporting entity shall maintain records of conclusion of risk assessment and all related details and information.
(5) Reporting entity shall conduct and update the risk assessment pursuant to subsection (1) periodically or as per necessity.
(6) Reporting entity shall make available to the Regulator any risk assessment undertaken pursuant to subsection (4), and also make it available to other concerned agency upon demand.
(7) Reporting entity shall undertake customer due diligence measures in accordance with the level of risks as identified pursuant to this section and shall establish appropriate policy, procedural and risk management measures, to manage and mitigate such risks and update such measures.
(8) Reporting entity shall regularly monitor the execution of policy, procedural and risk management measures pursuant to sub-section (7) to ascertain whether they are in implementation or not.

Reporting entity shall follow appropriate measures of enhanced **Customer Due Diligence (CDD)** when establishing business relationship or conducting transaction with/of following customer:-

(a) Customer identified as high risk.
(b) Customer who conducts complex, unusual large transactions and unusual patterns of transactions or which have no apparent economic or visible lawful purpose,
(c) Transaction with customer of a country, which is internationally, identified as a deficient or non-compliant country of international AML/CFT standards,
(d) PEP, his family member and person associated with PEP,

(e) Customer who need special monitoring,
(f) Customer consuming high risk products and services,
(g) Customer suspected of ML, TF or other offence,
(h) Other customers as prescribed by the Regulator.

Reporting entity shall adopt other measures as prescribed by the Regulator in the course of enhanced CDD. Reporting entity may adopt a simplified CDD for identification and verification of a customer and transaction where the risk of money laundering or terrorist financing is identified to be lower. However no such simplified measures of identification and verifications shall be applied if there is suspicion of ML and TF, high risked customer or transaction.

Reporting entity shall conduct the identification, verification and its adequacy of existing customer having business relationship or operating accounts till the day of commencement of Asset Laundering Prevention Act, 2008, based on the risks of the type and nature of customer and beneficial owner, business relation, transaction, products and services, geography, delivery channel. The time for identification and verification of existing customers shall be as prescribed by the Regulator.

Time Frame for the Identification of the Customers is prescribed by the Asset Laundering Prevention Act, 2008. Following provisions are mentioned in Section 7 H of the Act.

(1) Reporting entity shall identify and verify its customer and beneficial owner before establishing business relationship or opening an account, duringthe course of business relationship or when carrying out occasional transaction.
(2) Notwithstanding whatever written in subsection (1), Reporting entity, subject subsection (3), may make delayed verification of identity of the customer in the following circumstances, after the establishment of business relationship:
    (a) If verification may occur as soon as reasonably practical,
    (b) If it is impossible to verify the identification of customer due to practical reasons and verification would interrupt the normal conduct of business, and
    (c) If risk of ML/TF is effectively managed.
(3) No delayed verification of a customer shall be made if following circumstances exist:
    (a) If the customer is PEP, or of high risk or its family members or person associated with such customer,
    (b) If the activities of customer is suspicious

Reporting Entity is required to exercise ongoing due diligence including by carrying out the following activities:
(a) To closely examine the transactions of customer in order to ensure that such transactions are consistent with the information of customer, the customer‘s business and risk profile thereon,
(b) To request for or examine the source of funds if it is necessary in relation to inquiry pursuant to clause (a),
(c) To review and update the document, data, details or information of customers including PEP, high risk customer or of beneficial owner, their business relation, transaction in order to ensure that are kept up- to-date,

(d) To regularly monitor cross border correspondent banking and wire transfer and such customer,
(e) To perform other functions as prescribed by the Regulator, Other functions as reporting entity finds deemed necessary.

Identification and Verification by Third Party [Sec. 7J]

(4) Reporting entity may rely on a third party in undertaking some elements of customer identification and verification in the following circumstances:
   (a) If reporting entity is satisfied that all identification and verification of customer is carried out as per this chapter,
   (b) If information of identification and verification required by this chapter will be made available to reporting entity without delay as per necessity, and
   (c) If reporting entity is satisfied that all copies of identification and verification data and documents will be made available from the third party upon request, without delay.

(5) Notwithstanding whatever written in subsection (1), no identification and verification of a customer made by a third party shall be acceptable for reporting entity:
   (a) If such third party or institution belongs to a country identified as a deficient country in compliance of the international AML/CFT standards, or
   (b) If such third party or institution does not have measures in place consistent with the requirements set out in this chapter,
   (c) If such institutions are not under regulation, control and supervision to prevent and combat money laundering and terrorism financing.

(6) Ultimate responsibility for customer identification and verification under this chapter shall remain with the reporting entity relying on the third party.

New Technology & Non-face to face Customer or Transactions [Sec. 7K]

Availability of advanced information and communication technologies has made the life easier. Whether communicating with different people in different parts of the world or conducting business everything has become possible. On the one hand it has become the life easier but at the same time emergence of new technologies has increased the risk of money laundering and terrorist financing. Section 7K of Asset laundering Prevention Act 2008 has prescribed some provisions regarding new technology and non face to face customer or transactions which are as follows:

(1) Reporting entity shall identify and assess the money laundering or terrorist financing risks that may arise in relation to the use of new or developing technology or development of new products, business practices, delivery channels, non-face to face customer or transaction.
(2) Such identification and assessment of risk pursuant to subsection (1) shall be undertaken before the launch of the new product, business practice or the use of new or developing technology.
(3) Reporting entity shall take adequate measures to manage the risks identified and assessed pursuant to sub section(1).
(4) Reporting entity shall adopt policies and procedures to address risks of money laundering and terrorist financing in relation to non face to face customer when establishing a business

relationship, conducting transaction or conducting customer due diligence with such customer.

As per Section 7L of Asset Laundering Prevention Act, 2008 there are some obligations to be fulfilled by the financial institutions regarding wire transfers:

(1) Financial institution, mandated to undertake wire transfer services as per prevailing laws, shall accurately identify and verify the customer before dealing with wire transfer in any currency of any amount by obtaining the following information and details including
   (a) Name of the originator,
   (b) Account number of the originator or in the absence of it, a unique reference number,
   (c) Originator's address or, in the absence of the address, the citizenship or national identity number or customer identification number or date and place of birth,
   (d) Name of beneficiary and account number or in the absence of an account number, a unique reference number,
   (e) Other information or details as prescribed by the Regulator.

   Clarification: For the purpose of this section the term "Originator" also includes the beneficial owner transferring the money.

(2) Provisions of subsection (1) shall also be the same for wire transfers bundled into a batch file.

(3) Provisions of subsection (1) shall not be applicable if transfer is executed as a result of credit card, debit card or prepaid card transaction for the purchase of goods or services provided that the credit card, debit card or prepaid card number accompanies the transfer resulting from such transactions, or transfer between the accounts of financial institutions as mandated by prevailing laws pursuant to subsection (1) or (2).

(4) Reporting entity may not conduct identification and verification if the originator or beneficiary is existing customer and the reporting entity has already obtained and verified the information required by this section and there is no suspicion of ML/TF.

(5) Reporting entity may not require information pursuant to clause (c) of sub-section (1) if the transfer is NRs seventy five thousand or lower than this.

(6) Ordering financial institution shall include and ensure that information required pursuant to subsection (1) are attached with the payment message throughout the payment chain and to the receiving institution.

(7) Any institution working as an intermediary or receiving instituting in the chain of wire transfer in Nepal shall ensure that all information pursuant to subsection (6) have been received.

(8) If information is not received pursuant to subsection (7), the RE shall demand such information from the ordering institution or institution in payment chain.

(9) Any financial institution in Nepal, working as an intermediary or receiving institution, may suspend, deny or make payment of wire transfer in accordance with its policy and procedures of wire transfer subject to subsection (10) if the information demanded pursuant to subsection (8) is not available.

(10) Any financial institution in Nepal dealing wire transfer shall develop and implement a risk based on risks policy and procedures including for monitoring, inquiry, suspension, denial, identification of beneficial owner or beneficiary, payment of wire transfer.

(11) Any financial institution dealing with wire transfers shall conduct monitoring to ensure whether the information of originator and beneficiary is included or not.
(12) Any financial institution dealing with wire transfers and paying amount of NRs seventy five thousand or more shall identify and verify the beneficiary.
(13) Financial institution engaged on wire transfer as ordering, intermediary or receiving institution shall keep all details and records of wire transfer for five years at minimum.
(14) Financial institution transmitting money or value or making payment through wire transfer or acting as an intermediary while making such payment shall freeze the money immediately restricting access of anybody thereto if finds that such money is going to a person, organization, group or institution mentioned in chapter 6B.
(15) Financial institution servicing for wire transfer shall manage the followings in regards to its agents:-
   (a) Implementing the program of prevention and combating money laundering and terrorism financing and monitoring whether it is implemented or not.
   (b) Preparation of up-to-date information of agent and publish it in its website publicly.

Provision on Cross-border Correspondent Banking

Financial institution shall undertake the following measures while entering into cross-border correspondent banking and similar relationships or conducting transaction:

(a) To identify and verify the identification of respondent institution,
(b) To get adequate information on the nature of the respondent institution's activities,
(c) To fully understand the nature of the respondent‘s business from the information pursuant to clause (b),
(d) To evaluate the respondent institution's reputation and the quality of supervision to which it is subject to, including whether it has been subject to a money laundering or terrorism financing investigation or regulatory action based on publicly- available information,
(e) To evaluate the controls implemented by the respondent institution with respect to money laundering or terrorist financing and to ascertain their adequacy and effectiveness,
(f) To obtain approval from senior management before establishing a correspondent banking relationship,
(g) To understand and establish an arrangement on the respective responsibilities of each party under the relationship regarding AML/CFT,
(h) To ensure whether the respondent institution has conducted customer due diligence on customers in the case of a payable- through account, and has implemented mechanisms for ongoing monitoring with respect to its customers, and is capable of providing relevant identifying information on request,
(i) Not to enter into or continue correspondent banking relations with a shell bank,
(j) To satisfy itself that a respondent financial institution does not permit its accounts to be used by a shell bank.

Special Monitoring of Certain Transactions

There has to be special monitoring of certain transactions. The transactions which need special monitoring by the reporting entities are:

(a) All complex, unusual large transactions and all unusual patterns of transactions or which have no apparent economic or visible lawful purpose,
(b) Business relationships and transactions relating to the customer and financial institution of a country internationally identified as a country that do not or insufficiently comply with AML/CFT international standards,
(c) Such other transactions prescribed by the Regulator.

Reporting entity shall examine as far as reasonably possible the background and purpose of transactions referred above and record the conclusion drawntherein. Reporting entity shall keep the records of such measures taken for five years at minimum and shall be made available promptly if requested by the Financial Information Unit or Regulator or a competent authority.

Reporting entity shall not establish an account or continue business relationship or conduct transaction with the following customer:-
(a) Customer who cannot provide documents, information and details required for the customer identification and verification pursuant to this chapter,
(b) Documents, information and details provided pursuant to this Chapter seem conflicting to the identity of the customer,

Reporting entity shall terminate the relationship with the existing customer referred above and may inform Financial Information Unit (FIU) if necessary.

Responsibilities of Reporting Entity

It is the responsibility of the Reporting Entity to develop and implement AML/CFT Policy and Procedures compatible with its scope, geographic coverage, size of business, customer, transaction and risks for the prevention of money laundering and financing of terrorism and implementation of this Act, rules and directives thereunder. Such Policy and Procedures shall include the following:
(a) Internal policies, procedures and controls relating to relating to customer due diligence measures, information on transaction, verification, record keeping, monitoring, reporting,
(b) Ongoing monitoring,
(c) Arrangement to implement obligations as per this Act, rules and directives there under,
(d) Adequate screening procedures to ensure high standards when hiring employees,
(e) Ongoing and refreshment training for officers and employees,
(f) Independent and effective measures to review, verify and update and make compliance,
(g) Measures for detection and information of suspicious transaction,
(h) Other measures to fulfill the obligations as per this Act, rules and directives
(i) Other measures as prescribed by the Regulator.

Reporting entities shall have to appoint compliance officer at management level to comply the obligation pursuant to the provision of this Act or others rules and directives issued in accordance with this Act. Reporting entity shall ensure the following powers and necessary resources for the compliance officer:
(a) Access to any documents, records, registers and accounts necessary for the performance of his tasks,

(b) Power to request and obtain any information, notice, details or document from any employee of the reporting entity,
(c) Other responsibilities as prescribed by the Regulator,
(d) Other functions necessary to implement the Act, rules, and directives.

Record Keeping [Sec. 7R]

Reporting entity shall maintain following documents and records accurately and securely for minimum five years after the termination of business relationship or from the date of transaction in case of occasional transaction:-

(a) All documents and other information related to the identification and verification of customer and beneficial owner,
(b) All documents, records and conclusion of the analysis of customer or beneficial owner and transaction,
(c) Documents and details of account and business relation of reporting entity,
(d) All documents and records relating to domestic and foreign transactions,
(e) Record and documents on attempted transactions,
(f) Other documents and records as prescribed by regulators.

Reporting entity shall keep some prescribed documents and records for more than five years securely as prescribed. Reporting entity shall keep and maintain the documents and records in such a way that it shallbe sufficient to reconstruct such information for the use of legal action as evidence.

Documents and records to be maintained pursuant to this section should be kept in such way that it could be made readily available to competent authorities upon demand. Reporting entity shall keep the report of suspicious transaction for five years.

Obligation of Reporting Suspicious Transactions

Reporting Entity shall make a suspicious transaction report to the FIU within three days as far as possible if they find following circumstances in relation to any customer, transaction or property.

(a) If it suspects or has reasonable grounds to suspect that if the property is related to ML/TF or other offence, or
(b) If it suspects or has reasonable grounds to suspect that the property is related or linked to, or is to be used for, terrorism, terrorist, terrorist acts or by terrorist organization or those who finance terrorism.

Reporting entity shall also submit the report of attempted transactions or activity to FIU as mentioned above. Other additional grounds or guidance on detecting suspicious activity, format, method and procedure of reporting suspicious transactions and other related additional information shall be as prescribed by the FIU.

3. REGULATION & SUPERVISION OF REPORTING ENTITIES

Regulation, supervision and monitoring of reporting entity under this Act shall be conducted by the Regulator mandated for the regulation and supervision of such entity pursuant to prevailing

laws. The Government of Nepal, in case the event there is no Regulator mandated to regulate and supervise any reporting entity under prevailing laws may designate an agency or Regulator to work as a Regulator of such reporting entity, upon the advice National Coordination Committee. Regulator, in relation to the regulation and supervision of reporting entity, shall undertake the functions, responsibilities and powers set out in this Act, in addition to the functions, responsibilities and authorities prescribed under other prevailing laws.

Functions, Responsibilities and Powers of the Regulator

The functions, responsibilities and powers of the Regulator shall be as follows for the purpose of this Act:

(a) To undertake risk assessment to identify, evaluate, monitor risk in the reporting entity, its sector, periodically or as per necessity and adopt adequate measures to effectively manage risks,
(b) To require reporting entity to undertake risk assessment to identify, evaluate, monitor risk within the entity periodically or as per necessity and adopt adequate measures to effectively manage risks,
(c) To implement or cause to implement this Act and the Rules and directives issued there under,
(d) To impose mandatory conditions to comply the provisions of this Act for a person or institution while registering, licensing or issuing permissions or license for reporting entity or in the course of business,
(e) To develop and implement appropriate financial and other fit and proper test requirements while registering, licensing or issuing permissions to reporting entity and while approving those owning, controlling, or participating, directly or indirectly, in the establishment, management or operation or business of such entity, including the beneficial owner or beneficiary of such shares of the reporting entity or cause to do so,
(f) To require RE to apply the AML/CFT measures under Core Principles for prudential supervision,
(g) To conduct on-site inspection, off-site supervision and monitoring of reporting entity in order to ascertain the compliance of the provisions of this Act and rules, directives or order issued there under,
(h) to issue directives as per sub-section (2) and determine additional measures to REs for complying their responsibilities mentioned in chapter 3,
(i) To conduct comprehensive monitoring of the risk assessment and ECDD carried out by the RE in relation to the customer or transactions belonging to a country internationally identified as a non or partially compliant of AML/CFT standards,
(j) To order reporting entity to make any type of documents, books, records or details and any other information available for the compliance of this Act, and rules and directives or order issued there under,
(k) To provide necessary assistance in investigation,
(l) To make special assessment of the reporting entity about its mechanisms developed for the detection of suspicious transaction, its evaluation, reporting management on ML, TF pursuant to section 7S. or in other activities suspected or having reasonable grounds to suspect and their effective implementation,
(m) To inform FIU if any entity is found to have not submitted suspicious transaction report,
(n) To train or cause to conduct training programs to the RE on AML/CFT,
(o) To carry out other functions as prescribed.

Regulator may issue necessary order or directives or guidelines to reporting entity to implement or cause to implement the tasks under this Act and the provisions of international standards on AML/CFT. It may enter into cooperation and sharing arrangements with domestic or Foreign Regulators regarding the regulation and supervision of reporting entities operating under the same group and for the exchange of relevant supervisory information.

Financial Regulator may make necessary arrangements with domestic or similar Foreign Regulators regarding the system of regulation and supervision, and exchange of regulatory and supervisory information including other cooperation for AML/CFTsystem.

Regulatory Actions and Sanctions against a Reporting Entity

Regulator may take any or all of the following actions or sanctions against a reporting entity failing to comply with any provisions of this Act, Rules, or Directive issued there under or order.

(a) To issue written reprim and warnings,
(b) To impose fines from one million to NRs fifty million to the financial institution and from one hundred thousand to ten million to other reporting entity on the basis of gravity of violation of this Act, rules or order or directives issued there under,
(c) To impose full or partial restriction on the business, profession or transaction,
(d) To suspend the registration or permission or license,
(e) To revoke the permission or license or cancel the registration,

Regulator may impose other appropriate sanctions under prevailing laws if the sanctions provided as above are not sufficient for the violation of the provisions of this Act or Rules or directives or order thereunder. The imposed sanctions shall be effective, proportionate and dissuasive.

Reporting entity shall take appropriate action against a staff or an official if it faces regulatory actions or sanctions under this Act due to the activities of such staff or official as per its law or prevailinglaws. It shall provide reasonable opportunity of clarification to reporting entity before taking regulatory action or sanction pursuant to this section.

A reporting entity, which is not satisfied with the action or sanction of the Regulator, may appeal to the related High Court within thirty-five days.

4. NATIONAL COORDINATION COMMITTEE & FINANCIAL INFORMATION UNIT

Formation of National Coordination Committee

There shall be a National Coordination Committee constituted as follows to coordinate inter-related entities and to provide necessary suggestions to the Government of Nepal with regard to the prevention of money laundering and terrorist financing and predicate offences:

(a) Secretary, Office of Prime Minister and Council of Minister -Chairman
(b) Secretary, Ministry of Finance -Member
(c) Secretary, Ministry of Law, Justice and Parliamentary Affairs -Member
(d) Secretary, Ministry of Home Affairs -Member

(e) Secretary, Ministry of Foreign Affairs -Member
(f) Deputy Attorney General, Office of Attorney General -Member
(g) Secretary, Commission for the Investigation of Abuse of Authority -Member
(h) Deputy Governor, Nepal Rastra Bank -Member
(i) Inspector General of Police, Nepal Police -Member
(j) Chief, Department of Money Laundering Investigation -Member

The chief of the Financial Information Unit shall act as a secretary of the National Coordination Committee and the Financial Information Unit shall work as Secretariat of the National CoordinationCommittee. The procedures of meeting of the Coordinate Committee pursuant to Sub-Section (1) shall be as determined by the committee itself.

Function, Duty and Power of National Coordination Committee

The National coordination committee shall have following function, duty and power in addition to the function, duty and power mentioned elsewhere in this Act:

(a) To prepare policy for prevention of offences of ML/TF and submit the policy to the Government of Nepal,
(b) To coordinate in AML/CFT risk assessment and instruct the related agency for the management and mitigation of such risks,
(c) To implement or cause to implement the decision of the Government of Nepal taken for prevention of offences of ML/TF,
(d) To recommend to the Government of Nepal, as per necessity, to implement the standards and policies developed for prevention of offences of ML/TF by international organization of which Nepal is a member,
(e) To instruct concerned agencies for prevention of offences of ML/TF and to monitor whether or not the instructions are complied with,
(f) To discuss the annual reports submitted by the concerned agency, Regulator and FIU and make due coordination,
(g) To perform or cause to perform other tasks in relation to prevention of offences of ML/TF, as prescribed by the Government of Nepal.

Financial Information Unit

The Financial Information Unit shall be established as a department in Rastra Bank with functional independence and autonomy to receive suspicious transaction reports and other information related to money laundering, terrorist financing and predicate offences and analyze suspicious transactions and other information and to disseminate the results of such analysis to the Department.

The Governor of Rastra Bank shall appoint the chief of the Financial Information Unit from among the officers of Nepal Rastra Bank, not lower in rank than a First Class Officer. The Office of the Financial Information Unit shall be placed in Nepal Rastra Bank and the Rastra Bank shall provide the staff required for it.

Government of Nepal and other public bodies may make staff available to the Financial Information Unit upon request. Nepal Rastra Bank shall provide separate budget to the FIU. The

organization, staffing of FIU and minimum eligibility criteria, transfer, or termination of office of the chief and other staffs of FIU and other resources for FIU shall be as prescribed in the NRB By-laws.

Function, Responsibilities and Powers of Financial Information Unit

In addition to other functions, responsibilities and powers mentioned anywhere in the Act, FIU shall have following functions, responsibilities and powers:

(a) To receive threshold transaction report as per this Act,
(b) To receive suspicious transaction reports as per this Act,
(c) To receive the report of currency and BNI as per this Act,
(d) To receive other relevant information in accordance with the provision of this Act,
(e) To analyze suspicious transaction report, including others,
(f) To disseminate, spontaneously and upon request, analysis and related information to the Department or other investigation agency, if it suspects money laundering, terrorist financing, or other offence in its analysis pursuant to (e),
(g) To provide training on ML/TF to its own staffs, regulator, reporting entity and relevant government agencies having liability to perform under this Act,
(h) To provide feedback and guidance in relation to, including, the detection of suspicious activity, suspicious transaction report or information to the reporting entity or concerned agency,
(i) To prepare and submit an annual report, on its activities including the money laundering and terrorist financing typologies, techniques, methods and trends of offences, to the Government of Nepal through Rastra Bank,
(j) To assist in supervision of RE in coordination with Regulator as per necessity so as to know whether RE has developed mechanism to identify suspicious activity and reported or provide feedbacks on supervision report,
(k) To conclude MOU with foreign counter parts in order to exchange information upon reciprocity,
(l) To carry out other functions as prescribed.

Financial Information Unit may request any relevant information or cooperation needed to carry out its duties with a foreign counterpart that performs similar functions, or it may spontaneously or upon request, share its information or otherwise cooperate with such foreign counter part. It shall abide the terms and conditions mentioned by foreign counter part in relation to the information or cooperation received by it. It shall mention the prescribed terms and condition while providing information or cooperation to foreign counter part.

Financial Information Unit, in fulfilling its functions, responsibilities and powers pursuant to this section, may conduct the followings:

(a) Request and obtain necessary additional documents, records, details or information from reporting entity,
(b) Request and obtain administrative, financial or law enforcement documents, records, details or information or commercial database remained in or with concerned agency, regulator or public institution.

Confidentiality

(a) Information, documents, details on STR, TTR and other transactions received by Financial Information Unit shall remain confidential and the analysis of such reporting shall be used only as intelligence for the investigation of an offence or as within the limit prescribed in such dissemination.
(b) Every person who has duties for or within the Financial Information Unit is required to keep any information obtained within the scope of his or her duties confidential even after the termination of his duties, except as otherwise provided in this Act or as ordered by acourt.
(c) Financial Information Unit shall develop and implement mechanisms and procedures for management and confidentiality, secure use of information received pursuant to this Act, its use, analysis, dissemination, and exchange with foreign counterpart, and access to such information.
(d) Financial Information Unit may issue directives to any reporting entity or concerned agency in relation to the method, form, time and other procedures regarding reporting, notice and information requirements pursuant to thisAct. It shall publish the directives in it's website as well.

Establishment of the Department

Government of Nepal shall establish an Asset Laundering Investigation Department to investigate against and inquire into the offences under thisAct. The chief of the Department shall be at least a first class officer of civil service.

The organizational structure of the Department and required number of staff shall be as prescribed by the Government ofNepal. The Government of Nepal may make the required specialists available to the Department from the concerned entities or public institution.

Exchange of Cooperation Regarding Investigation

Department may request or provide for the exchange of the information of investigation with its foreign counter part carrying out the functions of similar nature, on the basis of reciprocity, upon demand or upon its own request. It may if it considers necessary, conduct investigation of money laundering and terrorist financing together with foreign counter part carrying out the functions of similar nature.

The Department may develop mutual arrangement with foreign counterpart carrying out the functions of similar nature to determine the method, terms and conditions and procedures for the exchange of cooperation.

5. PROVISIONS ON INVESTIGATION & INQUIRY

Complaint

Any person, who has knowledge that somebody has committed, is going to commit or is committing any act constituting money laundering and terrorist financing and predicate offences, may submit a complaint, application, information or notice to the Department in writing or oral form.

The Department shall register complaint, application, information or notice if it is received in writing and the Department shall transcribe the oral complaint, application, information or notice it receives and then register it.

However, if anyone complains with an intention to keep his name confidential, a code as designated by the Chief of the Department should be used in place of the name of the complainer while registering such complaint.

Information should be officially registered as complaint if any staff of the Department knows by any means that certain person(s) has committed or is committing or is going to commit money laundering or terrorist financing.

Complainer may be asked to endorse the complaint if sorequired. If the complainer endorsing requests for confidentiality of name, address, it shall be kept confidential.

Preliminary Inquiry or Investigation

The chief shall make or cause to make preliminary inquiry if he receives complaint or information. The chief may designate any of his staffs to conduct preliminary investigation and provide adequate time. The officer designated for the preliminary investigation may exercise the powers of the investigation officer available in this Act.

Appointment or Designation of Investigation Officer [Sec. 15]

(1) The chief, if he finds it reasonable to make an investigation of a case from the preliminary inquiry or investigation pursuant to section 14, may conduct investigation himself or appoint or designate an officer of the Department or of other Government agency or of public institution for the investigation of the case.
(2) The chief shall make prior consultation with the head of other Government agency or of public body before appointing an officer of such agency as an investigation officer pursuant to subsection (1).
(3) Notwithstanding anything written in subsection (1), the Chief may handover a case to an investigation authority for investigation if he finds that such authority is more appropriate to investigate such offence.
(4) Notwithstanding whatever written this section, the chief may, if he finds that the nature of offence demands two or more than two agencies or public body, may form a joint investigation team, with consultation with such agency or body.
(5) Investigating authority entrusted in accordance with subsection (3) or joint investment team formed pursuant to sub-section (4) may also use all the powers of investigation officer available under this Act.
(6) Investigation officer shall take oath of office before commencing the investigation in a prescribed form.
(7) Other provisions regarding the joint investigation shall be as prescribed.

Functions, Duties and Powers of the Investigation Officer

The functions, powers and duties of the investigation officer, subject to general direction and control of the Chief, shall be as follows:

(a) To order any government agency, regulator, reporting entity and related person to provide documents, records, statements, notices and/or information related to the offence of money laundering and terrorist financing,
(b) To conduct a search of any government entity, regulator, reporting entity, a person and any other place at which any document, write-up, material, facts, information, or instruments that mayconstitute evidence of an offence of money laundering and terrorist financing is reasonably believed to be located, and to seize such document, write- up, material, facts, information, or instruments or property or instrumentality related with the offence, provided that a written receipt in a prescribed form is given to the concerned person or official for all items seized in the course of the search,
(c) To arrest a person and detain a person, as per prevailing laws, if the investigation officer has reasonable grounds to believe that such person accused of or suspected of involving in money laundering or terrorist financing may abscond or destroy or hide evidences or likely to obstruct or create adverse influence in the investigation process,
(d) To require any person with information or reasonably believed to have information related to the offence of money laundering or terrorist financing to provide information, statement or supplementary statement,
(e) If the person while giving statement or supplementary statement under Sub-section (d) is found it necessary to provide additional information, he can be released on investigation officer‘s own undertaking by taking a written commitment or ask for bail and in case of inability to provide bail, detain with the consent of the court,
(f) To trace, identify and evaluate the properties and instrumentality fully and effectively in order to freeze or seize such property or instrumentality pursuant to section 18,
(g) To write to Financial Information Unit if there is reasonable ground to believe that foreign Financial Intelligence Unit may have any information,
(h) To carry out the other functions as prescribed.

The chief may fine up to Rs. five hundred thousand against a person disobeying the order given in the course of investigation, upon the report of the investigation officer.

Keeping Under Custody for Investigation

A detention warrant shall be provided to a person accused of or having reasonable grounds to suspect that he is involved in the offence of money laundering and terrorist-financing before detaininghim. The investigation officer shall present a person detained in money laundering and terrorist financing offence within 24 hour of arrest, except the time for arrival, and may be detained further upon the order of the adjudicating authority.

The Investigating officer shall, while producing the suspect for remand, clearly mention the charges against the detainee, reasons and grounds thereon, description of suspect's statement, if any, and the reason to detain the suspect forinvestigation. If remand is requested for investigation and inquiry, the adjudicating officer may, after reviewing the concerned documents and whether

or not the investigation and inquiry has been satisfactory, remand the suspect for ninety days, not exceeding thirty days at a time.

In case remand is requested, the detainee may petition before the adjudicating officer thereby stating reasons and grounds for him not to be remanded.

The investigation officer shall give prior information to the Chief of the Department before arresting, detaining or requesting the adjudicating authority to extend the detention time of a person pursuant to thisSection. However, if a person is required to be arrested right away, the investigation officer should inform the Chief as soon as possible after arresting such person.

Order for Freezing Assets [Sec. 18]

(1) The investigation officer may freeze or seize the following property or instrumentality or property or instrumentality suspected of being related with such property or instrumentality of anyone in the course of investigation, regardless of persons whoever owns, possesses, entitles, or has any kind of interest in:
   (a) Laundered property,
   (b) Instrumentality used or intended to be used in the commission of the offence of money laundering,
   (c) Property related with the offence of terrorist financing,
   (d) Property used or intended to be used in the offence of terrorist financing, or property used or intended to be used or allocated for the use in terrorist act or by (for the use of) individual terrorist, terrorist group or terrorist organization,
   (e) Instrumentality used or intended to be used in the offence of terrorist financing.

(2) The investigation officer shall freeze or seize the property of corresponding value of the person suspected of engaged in ML/TF if it is not possible to freeze or seize the property or instrumentality as stipulated in subsection (1), due to the disposal, concealment, use or consumption of such proceeds or instrumentality or by any other reason that disables to freeze or seize.

(3) The investigation officer may apply following measures while freezing or seizing the property or instrumentality pursuant to sub-section (1) or (2):
   (a) To self seize such property or instrument or through the concerned government agency,
   (b) To order concerned agency to freeze such property or instrumentality ex-parte and without prior notice to the person related.

(4) Notwithstanding whatever written in sub-section (1), the investigation officer may issue freezing order against the property of the person, under the investigation of ML/TF, who does not present before him within the time given or as delivered pursuant section 40 till such date such person presents oneself.

(5) The concerned agency or institution shall immediately freeze if it is asked in writing to do so pursuant to freeze pursuant to subsection clause (b) of subsection (3) or (4) in such a way that such property or instrumentality could not be transferred, mortgaged, sold, distributed, transacted or taken any benefit by anyone.

(6) The investigation officer shall give prior information to the Chief before giving order to freeze or seize the property or instrumentality pursuant to subsection (3) or (4).

Provided that, if such property or instrumentality is required to be frozen or seized right away, the investigation officer should inform the Chief as soon as possible after such freezing or seizing.

(7) The investigation officer shall give notice of freezing or seizing of the property to the person whose property or instrumentality is frozen within 3 days of such action.

(8) Person who is dissatisfied by the act of freezing or seizing made pursuant to this section may submit a complaint to the court prescribed pursuant to subsection (2) of section 22 for the release of such property or instrumentality.

(9) The court may, upon the receipt of complaint pursuant to sub section

(8) and if the property or instrumentality frozen or seized pursuant to subsection (1) is found to be belonging of the complainant, release such property or instrumentality if it finds the following circumstances:

(a) If the complainant is not found to be involved in any offence of money laundering or terrorist financing,

(b) If it is found that such property or instrumentality is not related with the offence of money laundering or terrorist financing or there is no ground to believe so, and

(c) If the property or instrumentality is not found to be related with other offence committed by the complainant.

(10) Notwithstanding whatever written in the prevailing law, investigation officer shall be vested with powers to prevent or void any contractual or other liabilities going to be created or created by any person that prejudices in the capacity of freezing, seize or confiscating the property and instrument that is subject to confiscation pursuant to section 34.

(11) The investigation officer shall submit a report of any freezing or seizing of the property made pursuant to this section to the person to the court within 3 days of such action.

(12) The court may issue appropriate and necessary order upon the report received pursuant to subsection (11).

Request to the Concerned Country

The Department, if it finds in the course of investigation that any property or instrumentality of any person related with money laundering or terrorist financing is in a foreign country, shall immediately request to freeze such property orinstrumentality pursuant to the prevailing laws. It shall include the more possible information about the place of the property or name of banks or financial institutions of such person.

Monitoring Order

The investigation officer may issue a monitoring order to a reporting institution directing it to provide information to the Department in respect of transactions of a person under the investigation of money laundering or terrorist financing offence with a form toreport. While issuing monitoring order the deadline shall be given no more than three months, in general.

A reporting institution served with a monitoring order shall regularly monitor the transaction of the person and report it to the department regularly in accordance with the terms of the order.

Seizing Passport or Travel Document

Notwithstanding whatever written in prevailing laws, the investigation officer may order the concerned entity to hold the passport or travel document of the person accused of in the offence of money laundering or terrorist financing. The concerned entity shall not issue a passport or travel document to such person or it shall take control of such document if it is ordered to take control.

Filing of Case

The Chief shall, after the completion of the investigation on the offence of money laundering or terrorist financing, submit a dossier of evidence including his advice to the government attorney for the latter to decide whether to file the case ornot. The Department shall, if it receives concerned government attorney's decision tofile a case, file the case before the court as prescribed by the Government of Nepal through a notice in Nepal Gazette.

There shall be no limitation to file a case relating to the offence under this Act. The Government of Nepal shall be the plaintiff in the case relating to an offence under this Act.

If any act constituting an offence under this Act is also punishable under any other existing law, one may also be charged under suchlaw. If it is evident from investigation of an offence under any existing law that one has committed an offence under this Act, the entity or officer conducting investigation and inquiry of such offence shall inform the same to the Department.

The Department shall inform other related investigation agency if it finds in course of its investigation that there is a link or possibility of filling another case or punishment under other prevailinglaws. It shall send all available information and complaint or file comprising the collected evidences, documents and conclusion in the course of investigation of money laundering or terrorist financing but not related with the offence of money laundering or terrorist financing to other related investigation agency under prevailing laws.

No Investigation Officer or any staff or person involved in the investigation and inquiry shall, unless the prevailing law otherwise requires, breach confidentiality of any matter or document s/he encounters with during investigation and inquiry or while performing his/her duty.

Any organized institution established under the prevailing laws or civil servant shall be deemed to be automatically suspended for a period he/she is detained as per this Act or until the case filed against him/her pursuant to Section 22 is settled.

Source of the Property to be Proved

Any person prosecuted under this Act for the offence of money laundering and terrorist financing after investigation shall require to provide the source of his property, if it is found that his property is unbelievable or he is living an unbelievable life style or he has unbelievably donated, gifted, granted or contributed or loaned to other more than his capacity in comparison to his income. Property failed to provide source shall be confiscated.

No Obstacle to Prosecute

It shall not be an obstacle to investigate, prosecute or punish a person on an offence of money laundering only due to the reason that no investigation has been conducted on predicate offence or not prosecuted even after the investigation or nor convicted on predicate offence or the charge of predicate offence has been dismissed.

6. CURRENCY AND BEARER NEGOTIABLE INSTRUMENTS

Declaration and Enquiry of Currency and Bearer Negotiable Instruments

Any person entering into or leaving Nepal, who is in possession of currency or bearer negotiable instruments or who arranges for the transportation of such items of NRs or its equivalent in foreign currency by cargo, courier, postal service or any other means of the amount or more as prescribed by the Rastra Bank shall make an accurate written declaration as prescribed. While making declaration, a person who is in possession of such currency or BNI shall declare it before the customs and a person who is sending or receiving such items by cargo, courier, postal service or any other means, it shall be declared before such agency.

A cargo, courier, postal service or any other means providing such service shall submit the declaration of currency or BNI to the nearest custom officer in a prescribed format. Custom officer may require disclosure of items declared or open the cargo, parcel or envelop submitted to him, if he suspects on the declaration or information submitted.

Custom officer may inquire about the origin and intended purpose of currency or BNI being carried into or out of Nepal in the following circumstances:

(a) If he suspects the declaration is not made or such declaration is false, or
(b) If there are adequate reasonable grounds to suspect that it is related with an offence.

Custom officer shall confiscate the currency or BNI if he finds such currency or BNI undeclared or falsely declared or related with an offence and also fine equal to such amount. Custom officer shall have to notify the reasons of confiscation to the concerned person.

Custom officer shall send a suspicious transaction report to FIU and inform the concerned investigation agency immediately, of the currency or BNI suspected as above. The Department of Customs shall send the details of declaration made pursuant to section 29A to Financial Information Unit every month.

Commodity Under the Customs Act

For the purpose of this Act, currency or bearer negotiable instruments shall be deemed to be an item under the definition of commodity (Malbastu) under the prevailing customs laws. Other provisions regarding declaration of currency or BNI, inquiry, search, seizure, confiscation, action or appeal pursuant to this chapter shall be as the provisions of the prevailing Customs laws.

7. FREEZING OF PROPERTY AND FUNDS

Information of Terrorist, Terrorist Group or Terrorist Organization [Sec. 29E]

The Ministry of Foreign Affairs shall without delay publish the list of terrorist, terrorist group or organization and of those engaged in proliferation of weapons of mass destruction designated under the provisions of the resolutions of United Nations Security Council in its website and submit the same to the Ministry of Home Affairs by electronic means.

The Ministry of Home Affairs shall, without delay, issue a freezing order against the properties or funds of terrorist, terrorist group or organization designated in the above list in order to freeze such properties or funds immediately in accordance with this chapter. The Ministry of Home Affairs shall immediately publish its order in its website.

The Ministry of Finance, Regulator, concerned agency, FIU, reporting entity or legal person or natural person shall ensure that they are aware of the updated lists of person, group or organization regularly consulting the lists.

Enlisting as a Terrorist, Terrorist Group or Terrorist Organization [Sec. 29F]

The Ministry of Foreign Affairs, if it receives a request from a foreign country in order to freeze the properties or funds of a person, group or organization related/involved with or suspected of being a terroristor terrorist group or organization, shall send such request to the Ministry of Home Affairs without delay.

The Ministry of Home Affairs shall make necessary inquiry against a person, group or organization involved or suspected of involving in terrorist act either upon the receipt of request of Ministry of Foreign Affairs or of Nepali or foreign citizen, group or organization involved in or having reasonable grounds of suspicion of being involved in terrorist act inside or outside of Nepal, in its own initiative.

The Government of Nepal may designate a person, group or organization as a terrorist, terrorist group or organization, if it finds or has reasonable grounds to believe that such person, group or organization is involved or going to be involved in terrorist activities or of section 4 or in any terrorist act pursuant to prevailing laws in Nepal or any other country under prevailing laws and issue freezing order against the properties or funds of such person, group or organization. The Government of Nepal may delist a person, group or organization listed if it does not find grounds for keeping such person, group or organization into such list.

The Ministry of Home Affairs shall, if any person, group or entity is delisted by the Government of Nepal, immediately publish its notice in its website.

Freezing of Properties and Funds [Sec. 29G]

(1) Natural Person, legal person, concerned agency or reporting entity shall immediately and without delay and without prior notice, freeze the properties or funds of a person, group or organization listed pursuant to section 29E & 29F and of person, group or organization engaged or financing in the proliferation of weapons of mass destruction.

(2) While freezing the properties or funds in accordance with sub-section (1), all the following properties or funds shall be frozen without delay:
   (a) All properties or funds belonging to or wholly or jointly, directly or indirectly, owned or possessed or held or controlled by such person, group or organization,
   (b) All properties or funds derived or generated from the property or funds pursuant clause(a),
   (c) All properties or funds of a person, group and organization acting on behalf of, or at the direction of such person, group or organization.

(3) Properties or funds frozen pursuant to this section shall be frozen in such away that such properties or funds shall not be, could not be transferred, mortgaged or sold or distributed or transacted by anyone, except in the execution of the provision of this Act and rules there under.

(4) Natural or legal person, concerned agency and reporting entity shall make necessary management that the such properties or funds or other economic resources or financial or other benefits frozen pursuant to subsection (1) and (2) shall not be, directly or indirectly, available or in use of or be beneficial to the individual, group or organization designated under sections 29E and 29F.

(5) Natural or legal person, concerned agency shall submit the report of such freezing pursuant to subsection (1) and (2) to the Ministry of Finance and reporting entity to the Regulator, within three days of freezing.

(6) Regulator shall submit the detail of the freezing of the property or funds received pursuant to subsection (3) to Ministry of Finance within three days of receipt.

Delisting or Defreezing the Properties and Funds

Any person, group or organization designated in the list of section 29E, and 29F may submit an application to the Ministry of Foreign Affairs and Ministry of Home Affairs respectively. Any person, group or organization affected by the freeing of properties or funds or on other matters due to the order under section 29G may submit an application to the Ministry of Foreign Affairs if the designation has been made pursuant to section 29E and to Ministry of Home Affairs if the designation has been made pursuant to section 29F.

The concerned Ministry shall make an inquiry if it receives an application pursuant to above and the Ministry of Foreign Affairs shall submit it to the UNO if the applicant is under the list of section 29E. The Ministry of Home Affairs shall submit it to the concerned foreign country through the Ministry of Foreign Affairs if the applicant is under the list of section 29F.

The Ministry of Home Affairs shall make an inquiry if it receives an application pursuant to above from the person, group or organization designated upon it own initiative under the list of 29F. It may delist such person, group or organization if it does not find any ground to keep applicant under the list of section 29F and shall make defreezing order for his frozen properties or funds.

Other provisions including the effective implementation of United Nations Security Council Resolutions including listing o rdelisting of terrorist, terrorist group, terrorist organization, listing or delisting of terrorist, terrorist group, terrorist organization pursuant to section 29F defreezing

properties or funds frozen pursuant to section 29G, appealing against the listing or freezing order, proper protection of bona-fide third party, providing minimum properties or funds for the subsistence of person whose property or funds is frozen shall be as prescribed.

Requests to Concerned Country

The Ministry of Home Affairs shall immediately send the list of person, group or organization listed pursuant to section 29F through the Ministry of Foreign Affairs with a request to freeze properties or funds of such person, group or organization if it finds that their properties or funds may be located in another country. The Ministry of Home Affairs shall send the name of person, group or organization if it is delisted through the Ministry of Foreign Affairs in order to defreeze property or funds that are frozen.

Punishment for Violations [Sec. 29K]

(1) Regulator may impose sanction pursuant to section 7V if it finds any reporting entity is not freezing the properties or funds pursuant to section 29G.
(2) Departmental action shall be taken against responsible officials of the concerned agency not freezing the property or funds pursuant to section 29G.
(3) The Ministry of Home Affairs may fine up to one million rupees to a natural or legal person violating the section 29G.
(4) Notwithstanding whatever written in the subsections (1), (2) or (3), case of TF may be initiated or filed against a natural person, legal person or responsible official of concerned agency or reporting entity who does not freeze the properties or funds with an intention tosupport the commission of offence of ML or TF, or to terrorist, terrorist group or organization or terrorist acts.
(5) The provisions under this Act, for tracing properties and instrumentality, freezing, seizing, investigation and confiscation of the properties or funds of terrorist, terrorist group or organization and other related matters, s shall be applicable to offences under this chapter if so required.

8. MISCELLANEOUS

Punishment for Offence of Money Laundering or Terrorist Financing [Sec. 30]

(1) Any person who has committed the offence of money laundering pursuant to sub-section (1) of section 3 shall be fined two times of the proceeds and imprisoned from two years to ten years as per the gravity of the commission of act.
(2) Any person who has committed any offence of conspiracy to commit the money laundering pursuant to subsection (2) of section 3 shall be punished pursuant to sub-section (1) and person committing other offences under the subsection (2) of section 3 shall be punished half of the sub-section (1).
(3) Any person who has committed any offence of terrorist financing pursuant to sub-section (1) of section 4 shall be imprisoned from three years to twenty years as per the gravity of the commission of act and fined five times of the proceeds, if it is apparent and fined up to ten million NRs, if such proceeds is not apparent.

(4) Any person who has committed the offence pursuant to sub-section(2), (3) or (4) of section 4 shall be half of the sub-section (3).
(5) If a person commits the offence of ML/TF through or by the use of a legal person, such person, official or staff shall be punished pursuant to sub-section (1), (2), (3) or (4).
(6) The chief of legal person working during the period of commission of the offence shall be punished pursuant to prevailing laws if the particular person committing such offence is not traced out asper sub-section (5).
(7) Punishment to a public servant or chief or staff of a reporting entity shall be punished ten percent more of the punishment stipulated in sub-sections (1), (2), (3) or (4) if he is found to have committed the offence of ML/TF.
(8) If any legal person or arrangement commits any offence of money laundering or terrorist financing, one or all following punishment shall be awarded on the basis of the gravity of offence:
    (a) Fine up to five times of the fine stipulated in subsection (1), (2), (3) or (4), and/or
    (b) Prohibiting in public procurement by prescribing time limit
    (c) Prohibiting in subscribing goods or services by prescribing time limit
    (d) Recovering losses and damages
    (e) Cancel or evoke license or permission,
    (f) Liquidating legal person.
(9) If any anyone, who violates any provision of this Act and rules issued there under beyond sub-section (1) to (8), shall be punished with the confiscation of property and fine equal to that, and if the property is not apparent, fine up to NRs. one million.

Other Punishments

(a) Punishment to the Discloser of confidentiality: Anyone who violates the confidentiality pursuant to subsection (2) of section 10B or section 26 shall be punished with imprisonment from one month to three months or fine up to one hundred thousand rupees or both.

(b) Punishment for Concealing or Destroying Evidences: Any person who commits the offence of concealing or destroying evidence related to acts deemed to be an offence under this Act shall be liable to the imprisonment of one month to three months and/or fine of fifty thousand rupees to one hundred thousand rupees in accordance with the gravity of offence and the person assisting the commission of such act shall be liable to half of such punishment.

(c) Punishment for Obstruction: If any person obstructs the proceedings of investigation, the adjudicating officer may, on the basis of investigation officer's report, punish him/her with a maximum imprisonment of six months and/or a maximum fine of five thousand rupees.

(d) Punishment for Making Trouble or Harassment: The Hearing Officer may fine up to ten thousand rupees on the basis of the report of investigation officer to the person who makes complaint unnecessarily or with the motive of troubling others.

Property Related With the Offence of ML/TF to be Confiscated [Sec. 34]

(1) Any following property or instrumentality related with offence shall be confiscated upon conviction on the offence of money laundering or terrorist financing, regardless of whoever entitles, owns, possess or has any kind of interest in:

(a) Property related with the offence of money laundering,
(b) Instrumentality used or intended to be used in the commission of the offence of money laundering,
(c) Property related with the offence of terrorist financing,
(d) Property used or intended to be used in the offence of terrorist financing, or property used or intended to be used or allocated for the use in terrorist act or by (for the use of) individual terrorist, terrorist group or terrorist organization,
(e) Instrumentality used or intended to be used in the offence of terrorist financing,

(2) Property of corresponding value shall be confiscated if it is not possible to confiscate such property or instrumentality as stipulated in subsection (1), due to the disposal, concealment, use or consumption of such proceeds or instrumentality or by any other reason.
(3) There should be proper protection of bona-fide third party while confiscating the property or instrumentality pursuant to sub-section (1) or (2).
(4) Not withstanding whatever written in subsection (3), property or instrumentality and other property or value generated there from of the bona-fide third party not involved in the offence shall be confiscated if the following circumstances exist, for the purpose of subsection (3):
(a) If such property or instrumentality is not found to be related with the offence of money laundering or terrorist financing,
(b) If such property is not the proceeds of crimes or instrumentality related with offence, or
(c) If such property or instrumentality is found to have acquired before the commission of the offence of money laundering or terrorist financing and without knowledge that such property may be used in offence.

National Risk Assessment

National risk assessment of money laundering or terrorist financing or predicate offence shall be conducted periodically or as per necessity. The Implementation Committee shall be responsible to conduct such national risk assessment. The composition, functions, responsibilities, powers of the Implementation Committee and other provisions regarding the national risk assessment shall be as prescribed.

Property or Instrumentality to Be Released

In case the property or instrumentality frozen pursuant to Section 18 proves to have no criminal origin, the Department if case has not been filed, or the court hearing the case if the case has been filed, shall order the concerned authority which has frozen the property or instrumentality to release such property or instrumentality and the concerned entity shall release such property or instrumentality upon such order.

Not to be Liable for Providing Information:

No staff or official of RE is supposed to have violated the professional or financial norms prescribed under other prevailing laws if such act has been carried out in the course of discharging duties under this Act up to the level of performance mandated under this Act.

No criminal, civil, disciplinary or administrative action or sanction shall be taken against a government agency, reporting entity or any of their official or staff who in good faith submit reports or provide report, document, information, notice or records in accordance with the provisions of this Act, rules and directives issued thereunder as a breach of secrecy provision under prevailing laws or contractual, administrative or regulatory liability.

Departmental Sanction to the Staff involved in Investigation and Inquiry

If any Investigation officer or any staff of the Department acts with mala-fide intention to cause troubles or tension to anyone in course of investigation and inquiry of the offences under this Act, the secretary of the concerned ministry where such staff is the chief of the department and the chief of the department in case of other staffs shall award departmental sanction notwithstanding whatever is mentioned in prevailing laws.

Provisions Relating to Delivery of Notice

Notwithstanding anything contained in the prevailing laws, a summon to be served to a foreign national in connection with an offense under this Act shall be served to the office or representative of such person in Nepal, if any, and the notice so served shall be deemed to have been duly served.

In case no office or representative as stipulated above exists, the notice shall be served to the main place of business of such person or his/her permanent residential address or the mailing address if provided by him/her in course of business, through telex, tele-fax or other means of tele-communication or through registered mail and the summon so served shall be deemed to have been duly served.

It shall not bar to serve the summon to the foreign national as per the specific provision contained in the treaty which Nepal or the Government of Nepal is a party to, if there is any.

Publication of Notice

In case a notice or summon cannot be served to any person as per this Act or any other prevailing law because the address of such a person is not identified or because of any other reason and a report thereof is received, a notice containing a brief detail of the case shall be published in national level newspaper (in English daily in case of foreign national) at least twice requiring the concerned person to appear within thirty days before investigating authority or adjudicating authority where charge has been filed. If such notice is so published, it shall be deemed to be duly served to such person, notwithstanding anything contained in prevailing laws.

Interpretation of Intention

Interpretation of knowledge, intent or purpose of the person accused of money laundering or terrorist financing shall be inferred from objective factual circumstances.

No Obstruction to Adjudication and Settlement Proceedings

Notwithstanding anything mentioned in prevailing laws, no death of the suspect before or after the filing of charge shall bar the adjudication and settlement proceedings of a case under this Act.

Waiver of Penalty

The investigation officer may present an accused person cooperating with the investigation and inquiry proceedings as his witness and may provide such person with full or partial waiver of penalty in the case initiated under this Act.

However, notwithstanding anything mentioned in this Act or in prevailing laws a law suit may be reregistered against such person if his cooperation could not be corroborated by other evidence or if such accused makes statement before the adjudicating officer against the cooperation extended to the investigation and inquiry officer.

Tipping Off and Related Provision

No reporting entity, nor its official or staff shall disclose to its customer or to any other person that a following report, document, record, notice or information concerning suspected money laundering or terrorist financing or predicate offence has been or is being submitted:-

(a) Report of suspicious or threshold transaction,
(b) Report of ongoing monitoring order pursuant to section 19A,
(c) Any document, record or information provided to the Financial Information Unit, investigation officer or investigation authority pursuant to prevailing laws or regulator,
(d) Other details or information to be provided by reporting entity under this Act, rules and directives there under,
(e) Individual introductory detail of an official or staff providing report, document, document, notice or information from (a) to (d).

The Department, investigation officer or staff of the Department, investigation authority pursuant to prevailing laws shall not disclose any information about the personal or institutional detail of the reporting institution, Financial Information Unit or their official or staff submitting a notice or report or document, record or information that will identify or is likely to identify the RE or FIU and a person or official reporting or disseminating in relation to the offence of money laundering, terrorist financing or predicate offence to anyone.

No information shall be disclosed even in judicial proceedings that discloses or may disclose the introduction of official or staff or agency or institution stipulated above. Following authority may impose following sanction at each event of violation of the provision of this section as follows:

(a) Regulator to fine up to one million rupees to the bank and financial institution or to casino,
(b) Regulator to fine up to two hundred thousand rupees to other designated non-financial business and profession,
(c) Reporting entity to take departmental action to its official or staff under their own laws,

(d) Notwithstanding whatever written in the prevailing laws of service, concerned authority to take departmental action against the Chief, investigation officer or staff of the Department or investigation officer pursuant to prevailing laws,
(e) Notwithstanding whatever written in the prevailing laws of service, departmental action to the head and staff of Financial Information Unit.

Confidentiality Provision

Notwithstanding whatever written in prevailing laws, no document, record, detail, notice or information stated to be remained confidential under the prevailing laws shall be confidential to the Department or Financial Information Unit for the performance of the duty under this Act. The concerned agency, official or person shall make available the document, record, detail, notice or information if they were asked by the Department or Financial Information Unit specifying the objective.

Nominal Expenses may be allowed

Where all asset of an individual is frozen in course of investigation and inquiry of the offence of ML/TF or in course of the proceeding of the case and there is no other means or source of livelihood for the concerned person or his/her dependents, the court may order the department to release the portion of the asset required for basic condition of livelihood. The department shall act upon the order of the court.

Processing Records by Computer as Evidence

Notwithstanding anything contained in any prevailing laws, except it is proved otherwise for the purpose of this Act, the record processed or developed by the electronic means can be taken asevidence. The essential provisions for the purpose of receiving, analyzing or processing record, particular and data shall be as prescribed.

Information to be Provided to the Ministry of Foreign Affairs

The Department, Regulator or Financial Information Unit shall immediately inform the Ministry of Foreign Affairs if a memorandum of understanding was concluded with foreign counter part pursuant to this Act.

Reward

Any person who files complaint or provides information and cooperates with the investigation or evidence collection shall be entitled to receive ten percent of the claimant value or rupees one million, whichever is lower, if allegation is established. In case the persons are more than one, such amount shall be distributed proportionately.

CHAPTER- 14

PUBLIC PROCUREMENT ACT, 2063 (2007)

1. INTRODUCTION

It is the concern of any government to achieve and enhance the effectiveness, efficiency, transparency and equity in public procurement because public procurement "affects all aspects of people's lives and assumes a large share of government budget. The Government of Nepal is the largest procuring (goods, works, and services) institution in the country. Almost 60 % of the annual national budget goes to procurement. Hence public procurement plays a critical role in the economy and is an important factor in economic growth. Public procurement reform is one of the major reform areas in improving financial governance in the country. Public procurement system is relatively new in Nepal and is undergoing various strengthening activities.

Brief History of Public Procurement in Nepal

Rules (Procedure) Regarding Public Fund Spending 1958 was implemented in 1958/59, which was the first law related to public procurement. This regulation assigned the procurement activities of the ministry to the concerned secretary. In order to address the issues related to public procurement such as transparency, competitiveness and accountability, financial administration related Act and Regulations were changing from time to time. The Financial Administration Rules 1985/86, Financial Administration Rules 1995/96 and Financial Administration Rules 1999 were the examples. In the continuous process of bringing public procurement reform in Nepal, as in majority countries of the region, Public Procurement Act 2063 was enacted in 2063. The Act was authenticated and published on 30thPaush 2063. Following are some of the major reasons for enactment of separate procurement law:

- To make procurement process more competitive- the existing Financial Administration Rules 1999 contained provisions limiting competitions in public procurement,
- To reduce the time consumed in procurement process- prevalence of two envelope system and bid may be cancelled without any valid reason,
- To make the procurement process result oriented and based on adequate preparation- in case single bid, the bid could not be accepted, consultancy services could be procured through quality & cost based selection (QCBS) method only,
- To promote the competitiveness in public procurement,
- For proper allocation of risks- no provision for price adjustment for contract of duration less than 18 months,
- To select qualified bidder rather than to select the lowest bidder,
- To promote accountability, transparency, and justice in public procurement,
- To assure good and quality procurement.

Government of Nepal has formulated the Public Procurement Rules, 2064 by virtue of the powers conferred to it pursuant to section 74 of the Public Procurement Act, 2063. The Objective of the Act is as follows:

- To make legal provisions in order to make the procedures, processes and decisions relating to public procurement much more open, transparent, objective and reliable,
- To obtain the maximum returns of public expenditures in an economical and rational manner,
- To promote competition, fairness, honesty, accountability and reliability in public procurement processes,

- To ensure good governance by enhancing the managerial capacity of procurement of public entities in procuring, or causing to be procured, construction work and procuring goods, consultancy services and other services by such entities and
- To ensuring the equal opportunity for producers, sellers, suppliers, construction entrepreneurs or service providers to participate in public procurement processes without any discrimination.

Section 3 of the Act provides that in making procurement, a Public Entity shall have to make such procurement by complying with the procedures set out in this Act. In making procurement, by an entity registered under prevailing laws, while making procurement by using governmental fund, to that extent shall have to make such procurement by complying with the procedures set out in this Act. Any procurement made in such a manner as to be contrary to this Act shall be void and invalid.

In this Act, following terminologies are defined as follows:

(a) Procurement: "Procurement" means acquisition of any goods, consultancy services or other services or carrying out or causing to be carried out any construction works, by a public entity pursuant to this Act.

(b) Public Entity: "Public Entity" means the following entity:

- Constitutional organ or body, Court, Ministry, Secretariat, Commission, Department of Government of Nepal or Provincial Government or any other government entity or offices under it,
- Commission, Department of the Government of Nepal or any other Governmental Entity or Office thereunder, Corporation, Company, Bank or Board owned or controlled fully or in majority by the Government of Nepal or Provincial Government or Commission, Institute, Authority, Corporation, Academy, Board, Center, Council established at the public level or formed by the Government of Nepal or Provincial Government under the laws in force and other corporate body of a similar nature,
- University, College, Research Center, which is operated by the Government of Nepal or Province Government or receives grants fully or in majority from the Government of Nepal or Provincial Government, and other Academic or Educational Institution of a similar nature,
- Local Level,
- Development Board formed under the Development Board Act, 2013,
- Body operated with loan or grant of the Government of Nepal or Provincial Government, and
- Other Bodies as specified by the Government of Nepal or Provincial Government by publishing a notification in the Nepal Gazette, as a Public Entity.

(c) Construction work: "Construction Work" means work such as site preparation, excavation, erection, installation of equipment or goods and decoration etc., associated with the construction, reconstruction, demolition, repair or renovation of any structure or works, and this term also includes services incidental to construction work such as mapping, laboratory testing, satellite photography and seismic investigation.

(d) Consultancy Service: "Consultancy Service" means any study, research, survey, design, drawing, supervision, training, testing, software development service or other intellectual or professional service of a similar nature.

(e) Other Service: "Other Services" means the act of hiring motor vehicles, equipment or goods, carriage or repair and maintenance of goods.

(f) Bid: "Bid" means a document setting out price, proposal or rate submitted by a bidder in the format specified by a Public Entity as per the notice published by that entity for procurement.

(g) Bidding document: "Bidding Document" means a document prepared by the concerned Public Entity making invitation to bid for submission by bidders by filling up or preparing price or proposal or rate in such document and this term also includes instructions to bidders, specifications, drawing, design, terms of reference, schedule of work, evaluation criteria, bill of quantities, conditions of contract and similar other documents.

(h) Procurement contract: "Procurement Contract" means a procurement contract entered into between a Public Entity and a supplier or construction entrepreneur or consultant or service provider.

(i) Competent Authority: "Competent Authority" means an authority authorized under this Act or the rules made thereunder to approve proceedings regarding procurement.

(j) Local level: "Local Level" means Rural Municipality, Municipality or District Assembly constituted under prevailing laws.

(k) One level Higher Authority: "One Level Higher Authority" means in relation to governmental entities, in the case of the head of office, the head of a regional office where there is such regional office and the departmental head of the concerned department where there is no regional office, in the case of regional head, the departmental head of the concerned department, in the case of departmental head, the secretary to the concerned ministry, secretariat or commission, in the case of a Secretary, the concerned departmental Minister or Minister of state, and in the case of a Secretary or administrative head of a constitutional organ or body, the head of the concerned constitutional organ or body and in the case of other public entities, the head of an entity that is one level higher than the procuring entity and the board of directors or similar other body of such Public Entity where there is no such entity.

(l) Donor party: "Donor Party" means any foreign country or international or foreign organization, which provides foreign assistance in the form of loan or grant to the Government of Nepal under a bilateral or multilateral agreement.

(m) Ration: "Ration" means the goods in-kind prescribed by the Government of Nepal in respect of foods for the Nepal Army, Nepal Police, Armed Police Force or governmental employees, patients at hospitals, detainees in prisons, animals and birds etc as specified by the Government of Nepal;.

2. RESPONSIBILITY FOR PROCUREMENT & PROCUREMENT METHODS

Preparation of Description of Goods, Construction Works and Services

A Public Entity shall have to prepare specifications, plan, drawing, design, special requirement or other descriptions pertaining thereto prior to procuring goods, construction works or services. The description shall be prepared on the basis of relevant objective, technical and quality characteristics and functions of such goods, construction works or services. In preparing the description, unless there exists any other way of mentioning clearly in a clear manner the characteristics of the goods, construction works or services, a particular brand, trademark, name, patent, design, type, origin or producer's name cannot be mentioned. However, a particular brand, trademark, name, patent, design, type, origin or producer's name shall be mentioned and the words "equivalent to" shall be mentioned thereafter in case there is no other way than such mentioning.

Rule 3 of Public Procurement Rules, 2064 provides that in making preparation for a procurement proceedings, a Public Entity shall have to do as follows:

- To identify procurement requirements,
- To obtain information of the procurement contract in practice in the market in order to resolve various technical matters pertaining to procurement and to ascertain the availability of supplier,
- If goods, construction work or consultancy service or other service of similar nature was procured in the previous year, to study such procurement proceedings,
- To ascertain the details, quantity and scope of procurement,
- Dividing the procurement into a more convenient group or including into package,
- To cause the procurement plan to be prepared,
- To prepare cost estimate of procurement,
- To identify financial source and amount of procurement,
- To select procurement method, and
- To ascertain, in the case of a procurement other than the procurement of a construction work of up to Rs. 2 crores, whether the bid qualification or pre-qualification proceedings requires to be carried out or not.

Preparation of Cost Estimate

A Public Entity shall have to prepare and approve a cost estimate as prescribed for any procurement whatsoever. However, a cost estimate shall not be required for any procurement valuing up to Rs. 100,000 other than construction works. According to Rule 9, the following matters shall be considered in preparing cost estimate of any procurement:

- Whether the whole procurement works may be carried out through a single contract or a separate contract requires to be concluded for each work,
- Whether the procurement contract requires to be renewed or not,
- Other options to procurement, if any,
- Maximum time and cost that may require to complete the work under the procurement contract, and

- Other matters specified by the Public Procurement Monitoring Office as required to be taken into account by a Public Entity in preparing cost estimate.
- Particulars or details of Rule 5A.

Preparation of Master Procurement Plan

Rule 7 of the Public Procurement Rule, 2064 provides that a Public Entity shall, in procuring for a plan or project to be operated for a period of more than one year or in making a procurement annually of an amount exceeding Rs. 10 crores, have to prepare a master procurement plan containing the following matters:

- Type, quantity and tentative estimated cost of procurement,
- Procurement method,
- If, for maximizing competition, procurement is to be made by the use of slice or package, provision relating thereto,
- Tentative numbers of contracts to be concluded in order to complete the whole procurement proceedings and major functions relating to such procurement proceedings,
- If pre-qualification proceedings requires to be carried out for procurement, matters relating thereto,
- Tentative time-table of procurement proceedings,
- The matters specified by the Public Procurement Monitoring Office from time to time as required to be included in a master procurement plan.

The master procurement plan prepared under this Rule shall have to be approved by the concerned secretary of the Public Entity in case of Public Entity pursuant to sub-clause (1) of clause (b) of section 2 of the Act (Constitutional organ or body, Court, Ministry, Secretariat, Commission, Department or government entity or offices of Government of Nepal or Province Government) and by authority (official) empowered by Procurement By-rule or bylaws of concerned Public Entity in case of other Public Entity. The concerned Public Entity shall have to update the approved master procurement plan in each fiscal year.

Preparation of Annual Procurement Plan

Rule 8 provides that if a Public Entity requires to make a procurement annually of an amount exceeding one million rupees, it shall have to prepare an annual procurement plan for the procurement to be made in the next fiscal year while preparing estimated annual program and budget of the next fiscal year. Such a procurement plan shall be based upon the master procurement plan under Rule 7, if such plan is prepared. The following matters shall have to be stated in the annual procurement plan:

- Description relating to the types of procurement,
- Possible package of procurement,
- Time table of procurement proceedings,
- Procurement method,
- Types of contracts to be concluded for procurement, and
- The matters specified by the Public Procurement Monitoring Office from time to time, as required to be included in the annual procurement plan.

The chief of the Public Entity shall have to send a copy of the annual procurement plan along with the estimated annual program and budget of the next fiscal year to the pertinent higher office and the Ministry of Finance. The chief of the Public Entity shall, after receiving the approved program and budget of the current fiscal year, have to revise accordingly the annual procurement plan prepared pursuant to this Rule and approve it and send one copy each of such plan to the pertinent higher office, Treasury and Accounts Comptroller Office and Public Procurement Monitoring Office. The pertinent higher office shall monitor whether procurement proceedings are completed in scheduled time or not.

Maintaining Inventory of Supplier, Construction trader, Consultant, etc.

Every Public Entity shall maintain separate inventory of supplier, construction trader, consultant, non-governmental organization or service provider on the basis of qualification referred to in section 10(2) for the procurement to be made under section 30(6), 41(1)(a) and 46 on the basis of nature of procurement.

Any supplier, construction trader, consultant, non-governmental organization or service provider desirous to be enlisted in the above list shall be required to submit an application to the concerned Public Entity along with the prescribed documents. It shall be the responsibility of the concerned Public Enterprise to update such list. The concerned supplier, construction trader, consultant, non-governmental organization or service provider shall be required to submit application to the concerned Public Enterprise for updating of the list.

Responsibility for Procurement Activities

It shall be the responsibility of the chief of the concerned Public Entity for carrying out or causing to be carried out all activities relating to procurement to be made by fulfilling the procedures referred to in this Act. A Public Entity shall, in carrying out procurement related activity carry out so through an employee who has the qualification prescribed by the Public Procurement Monitoring Office and has knowledge or training on procurement business.

A Public Entity shall establish a separate division, branch, or unit to carry out the following acts by appointing procurement officer:

- Preparing a procurement plan,
- Preparing prequalification documents, bidding documents and procurement contract related documents by making necessary amendments in the standard bidding documents, standard prequalification documents and standard procurement contract documents, bid documents, documents relating procurement agreement prepared by the Public Procurement Monitoring Office,
- Preparing documents relating to proposals for consultancy services without making necessary modification in the standard request for proposal prepared by the Public Procurement Monitoring Office,
- Publicly publishing the procurement notice,
- Issuing pre-qualification documents, bidding documents or forwarding documents relating to proposals for consultancy service,

- Receiving and safely keeping pre-qualification proposals, bids or consultancy service proposals,
- Submitting the pre-qualification proposals, bids or consultancy service proposals to the evaluation committee for evaluation and submit the evaluated bids for acceptance,
- Notifying the acceptance of the pre-qualification proposals, bids or consultancy service proposals,
- Obtaining, examining and safely keeping the performance guarantee,
- Examining, or causing to be examined, the quality standards of the goods, construction works or services that have been procured,
- Making available the information and documents asked for by the Public Procurement Monitoring Office, and
- Performing other functions as may be prescribed.

In carrying out or causing to be carried out the functions as mentioned above, the officer responsible for the procurement division, branch or unit shall carry out the same with the approval of the chief of the concerned Public Entity. It shall be the responsibility of the chief of the concerned Public Entity to implement the procurement agreement entered pursuant to this Act, to monitor and supervise on a regular basis the procurement activities and ensure completion of the work in the scheduled time.

Selection of Procurement Method

Section 8 of the Act provides that in making procurement pursuant to this Act and the rules framed under this Act, procurement shall not be so made in piecemeal (fractional) as to limit competition. A Public Entity while procuring shall have to procure by applying any of the following methods based on such conditions and purchase price as prescribed:

(a) For procurement of goods, construction works or other services:

(i) By inviting open bids at international level,
(ii) By inviting open bids at national level,
(iii) By inviting sealed quotations,
(iv) By procuring directly,
(v) Through participation of users' committee or beneficiary group,
(vi) Through force account,
(vii) Through lump sum method,
(viii) Catalogue shopping,
(ix) Limited Tendering,
(x) Buy back method.

(b) Procurement of consultancy service:

(i) By requesting competitive proposals,
(ii) Through direct negotiations.

Qualification of Bidder or Proponent

A bidder shall have to fulfill the following qualification in order to obtain a procurement contract:

- In the case of a bidder, the qualification criteria set forth in the bidding documents or where prequalification proceedings have been conducted for procurement, the qualification criteria set forth in the prequalification documents, and
- In the case of a consultant, the qualification criteria set forth in the documents relating to proposals.

In setting forth qualification as above in the bidding documents or documents relating to proposals, professional and technical qualifications, equipment availability, past performance, after-sale service arrangements, availability of spare parts, legal capacity, financial resources and condition, punishment for having committed professional offenses and similar other criteria may be set forth.

In setting the criteria, provision shall not be made so as to allow only a particular class of construction entrepreneur, supplier, and consultant or service provider to participate or to prevent any particular class of construction entrepreneur, supplier, consultant or service provider from participating in the procurement process. Bids, pre-qualification proposals and consultancy service proposals shall be evaluated only in accordance with the criteria set forth in the bidding documents, pre-qualification documents and in the documents relating to proposals, respectively, and such criteria shall equally be applicable to all bidders or proponents without any discrimination. The Public Entity may disqualify a bidder or proponent at any time if it finds that the statement submitted by such bidder or proponent concerning the qualifications was factually false or substantially incomplete. However, minor errors can be corrected by seeking information pertaining thereto from the concerned bidder or proponent.

3. PROVISIONS RELATING TO BID

A Public Entity shall have to procure goods, services or a construction work valuing above two million rupees through open bid. Goods, construction works and services shall have to be procured by inviting an open international level bidding in the following conditions:

- Where the goods or construction works as requisitioned by a Public Entity are not available under competitive price from more than one construction entrepreneur or supplier within the State of Nepal,
- Where no bid was submitted in response to invitation to national level bidding for the procurement of goods, construction works or other services, and the same has to be procured from abroad,
- Where under an agreement entered into with a donor party, foreign goods or construction works have to be procured from foreign assistance source,
- Where the Public Entity has certified that the goods or construction works, being of complex and special nature, have to be procured through an international level bidding.

A notice on invitation to international bidding shall be published in English language; and all bidding or prequalification documents shall have to be made available in the English language.

Such notice shall be placed in the website of the concerned entity or that of the Public Procurement Monitoring Office, in the case of a central level Public Entity, and in the case of a district level Public Entity, such notice may be placed in the website of that body or that of the Public Procurement Monitoring Office.

Process and Stage of Bidding

In making procurement by bidding, an invitation to bid can be made by the following process:

- Inviting open bids by determining prequalification,
- Inviting open bids without determining prequalification.

The open bid may be invited in a single stage or in two stages. In making invitation to bid it may be made in two stages in the following conditions:

- When it is not feasible to define fully the technical aspects of the goods or construction works or services to be procured or the terms and conditions of the procurement contract at the time of the invitation to bid, or
- If it is necessary for the Public Entity to discuss with the bidders about how to resolve the problems related to various technical aspects or the procurement contract and about such technical aspects and conditions of contract and benefits accruing therefrom, because of the complex nature of the goods or construction works or services to be procured,

Determination of Prequalification Prior to Making Invitation to Bids

The Public Entity shall prepare prequalification documents and publicly invite to proposals for the determination of prequalification prior to making invitation to bids for the procurement of such construction work as determined by the Public Procurement Monitoring Office from time to time to be large and complex, or to procure goods of high value such as industrial plants or with a view to identify qualified bidders (section 12). Where the Public Entity considers appropriate, it may also determine prequalification for other procurement as well.

The prequalification documents shall set forth the qualification criteria required for prequalification and the method for the preparation of proposal and the manner for the submission of proposal. The Public Entity shall provide the prequalification documents required to submit proposal to all persons, firms, companies and organizations that request for such document.

The selection of the qualified applicant shall be made on the basis of the set forth qualification criteria and the Public Entity shall openly publish a list of the applicants so selected and send the same to all applicants. If any applicant whose prequalification proposal is rejected, requests for the information of the reasons for the rejection of his or her proposal within 30 days of the notice being given, the concerned Public Entity shall have to provide such information to him or her.

Preparation of Bidding Documents

Section 13 of the Act provides that the Public Entity shall have to prepare the bidding documents prior to invitation to bid. It shall make available the bidding documents upon collection of the charges as prescribed to any person, firm, organization or company that requests for the bidding documents in accordance with the notice for invitation to bids, and where prequalification is

required to participate in the procurement proceedings, to those persons, firms, organizations or companies that have been pre-qualified and request for such documents. The bidding documents shall contain the following matters:

- The nature of procurement, time required for procurement and technical specifications thereof,
- Where bids are invited without carrying out prequalification, the criteria for qualification of bidders, as referred to in Section 10,
- Where there is provision of site visit, information relating thereto,
- If any bid conference has to be held prior to submission of bid, information relating to such conference,
- Instructions for preparing and submitting bids, the place for the submission of bids, the deadline for the submission of bids and the place, date and time for the opening of bids,
- Component of price, the currency or currencies in which the bid price may be stated, the currency and the source and date of the related exchange rate to be used for comparison of bids,
- The criteria and methodology for the evaluation of bids and the selection of bidder,
- The preferences to be given, if any, for domestic goods and local construction entrepreneurs, provision relating thereto,
- Where any goods or construction works are to be procured by making separate lots and packages, such lots and packages and the manner of evaluation thereof,
- Where alternatives to the technical specifications are also invited, the manner of evaluation of such alternatives,
- Where a bid can be submitted even only for a portion of the goods, construction works or services to be procured, a description of such portion or portions,
- The validity period of bid,
- The amount, type, acceptable form and validity period of security to be furnished for bid, performance or other necessary matters,
- Where a bid security is required, provision that the period of that security shall exceed by thirty days to the validity period of bid,
- The terms and conditions of the procurement contract under Section 52 and the modality of coming for the entry into force of that contract,
- Information that bids shall not be processed in the event of conflict of interest or information relating to legal action for fraud or corruption,
- Provision that any bidder may make an application, for review, against any error or decision made by the Public Entity in carrying out bid proceedings,
- Provision that the documents proving technical capacity and financial proposal (bid price) have to be submitted in one envelope,
- The financial or technical particulars to be submitted by the Bidder while submitting bid or entering contract with the Public Entity,
- If the bidder has started any work by entering into agreement with the Public entity, such entity, details of work, amount of agreement and details of work progress,
- Such other matters determined by the Public Procurement Monitoring Office as to be involved in the prequalification documents or bidding documents.

Invitation to Bids

A notice for invitation to bids or prequalification proposals shall have to be published in a daily newspaper of national circulation and in the case of an international bid, it may also be published in any international communication media by the Public Entity. The notice containing the following matters shall be placed in the website of the concerned entity or that of the Public Procurement Monitoring Office, in the case of a central level Public Entity, and in the case of a district level Public Entity, such notice may be placed in the website of that body or that of the Public Procurement Monitoring Office.

- The name and address of the Public Entity inviting bid,
- The nature of and time limit for procurement work and the place of delivery of the goods to be supplied, the services to be delivered and the construction work to be performed,
- If bid security is required, the amount and validity period thereof,
- Where bid security is required, the amount and validity period of the bid,
- The place, manner of obtaining the bidding documents or prequalification documents, and the fees charged therefor,
- The place, manner, the deadline for the submission or forwarding of the bidding documents or prequalification documents,
- The place, date and time for the opening of bids, and matter that the bidders or their authorized agents shall be invited to attend the opening of bid, and
- Other matters as prescribed.

In publishing such notice, for invitation of national level bidding or prequalification proposals, a period of at least thirty days shall be given and at least forty five days shall be given in the case of a notice on invitation of international level bidding or prequalification proposals. If no bid or prequalification proposal is received within this time limit or cannot be enforceable though received and required to call bid or prequalification proposal again, the Public Entity shall by providing minimum time period of 15 days in case of national level bid or prequalification proposal and 21 days in case of international level bid or prequalification proposal, may recall bid or prequalification proposal

If no recall bid or prequalification proposal is received within the time limit as mentioned above or cannot be enforceable though received and loss may incur or work of Public Enterprise may be stopped if immediate procurement is not made, the Public Entity may make procurement by providing such reason, with the approval of one level higher authority and by providing minimum time period of 7 days to submit bid or make procurement by selecting any procurement method pursuant to section 8.

In making procurement through an international level bidding, the Public Entity may give domestic preference to the Nepalese entrepreneurs and businesspersons and where domestic preference is to be so given, that matter shall be set forth in the notice on invitation to bid and the bidding documents. However, in the case of procurement of construction work through national level bid, procurement may be made by making competition between national bidders up to the prescribed cost estimate. A foreign bidder, while submitting bid, shall have to state whether he/she has appointed any agent in the State of Nepal or not and where an agent is appointed, the details as prescribed in relation to the agent shall also be set forth in the bid.

The Act also provides that where a foreign bidder enters into joint venture with a domestic construction entrepreneur, in the case of procurement of public construction work, preference may be given to such a foreign bidder.

Submission/Methods of Submission of Bids or Prequalification Proposals

The Public Entity shall have to so set the deadline for the submission of bids or prequalification proposals as not to be less than thirty days in case of invitation of national level bidding or prequalification proposals and not to be less than forty five days in the case of invitation of international level bidding or prequalification proposals.

A bid shall have to be submitted in the specified form, duly signed by the bidder himself /herself or his /her authorized agent in a sealed envelope by the bidder himself /herself or through his or her authorized agent or by post or courier at such place and within the last date and time as specified for the submission of bids. Bids received after the prescribed deadline shall not be processed and such bid shall be returned unopened to the concerned bidder. The method for submission of bids for procurement to be made by use of electronic communication shall be as electronic procurement system approved from Public Procurement Monitoring Office.

A bidder may make a sealed application for modification to or withdrawal of bid that a bidder has once submitted prior to expiry of 24 hours of the deadline for the submission of bids. The Act further provides that bids submitted via electronic communication shall not be modified or withdrawn. Other provisions relating to the withdrawal or modification of bid shall be as prescribed.

Validity Period of Bid and Bid Security

The validity period of a bid shall be as specified in the bidding documents. The period shall commence from the deadline for the submission of bids. The Public Entity may extend the validity period of bids as required assigning the reasons for the same if so required to extend the validity period of bids after the opening of bids. In extending the validity period of bid, consent of the concerned bidder shall have to be obtained. A bidder who agrees to extend the validity period of his/her/its bid shall correspondingly extend the validity period of bid security. The bid security of the bidder not providing consent in extending the validity period of bid shall be returned.

A bidder shall provide bid security along with the bid as prescribed. The furnished bid security shall be forfeited in the following conditions:

- If the bidder requests for modification or withdrawal of bid after the expiry of the period mentioned in section 19(1),
- If the bidder refuses to accept the correction of arithmetical errors found in the bid,
- If the selected bidder fails to sign the procurement contract in accordance with the terms and conditions set forth in the bidding documents,
- Where the bidder fails to furnish the performance security as set forth in the bidding documents within the time for signing the procurement contract,

- If the bidder has changed the bid price or substantive matter of the bid while providing any information in response to clarification sought by the Public Entity pursuant to Subsection (4) of Section 23 in the course of examination of bids.
- If any act contrary to conduct as referred to in Section 62 is committed.

The Public Entity shall return the bid security of the bidder who has signed the procurement contract and the bid security of those bidders whose bid security is not liable to forfeiture as mentioned above after the conclusion of a procurement contract.

Examination of Bids

The Public Entity shall have to open bids as prescribed at the time and place specified in the bidding documents on the same day immediately after expiry of the deadline for the submission of bids. The Public Entity shall have to submit the opened bids to the evaluation committee. The committee shall, prior to evaluating the submitted bids, examine the bids in order to ascertain the following matters:

- Whether documents establishing that the bidder is qualified under law to submit the bid are submitted or not,
- Whether the bid is complete in accordance with the instructions to bidders set forth in the bidding documents or not and whether it is signed by the bidder or by the bidder's authorized agent or not,
- Where a bid security is required to be submitted along with the bid, whether a bid security of such type, period and amount as set forth in the bidding documents is accompanied with the bid or not,
- Whether the bid is substantially responsive to the technical specifications set forth in the bidding documents and the terms and conditions of procurement contract attached with the bidding documents or not.

The Public Entity shall examine the following matters in examining the completeness of the bids:

- Whether a power of attorney for the authorized agent or local agent of the bidder is submitted or not,
- Where a joint venture agreement is necessary, whether such agreement is submitted or not,
- Whether documents establishing the eligibility of the bidder and of goods mentioned by the bidder are submitted or not,
- Whether necessary document relating to the qualifications of the bidder is submitted or not,
- Where the bidding documents require the submission of a rate analysis, whether such rate analysis is submitted or not,
- Other matters as prescribed.

In examining bids invited after determination of prequalification, examination of the qualification of bidder shall be made to ascertain whether or not it conforms to the prequalification or not. While examining the qualification, if the qualification of a bidder is found to be substantially lower than what was at the prequalification stage, the bid of such a bidder shall be rejected.

If any arithmetical error is found in a bid in examining bids, the Public Entity may correct such an error. In making such correction, if there exists a discrepancy between unit rate and total amount, the unit rate shall prevail, and the total amount shall be corrected as per the same rate. Where there is a discrepancy between figures and words in a bid submitted by a bidder, the amount in words shall prevail. Where any error relating to arithmetical error or discrepancy between figures and words is corrected, information of such correction shall be communicated to the concerned bidder.

Section 24 provides that bids having following non compliance shall not be processed:

- If it is not sealed,
- If it is not submitted within the time frame,
- If the bid is withdrawn pursuant to section 19,
- If it is not in accordance with sub-section (2) of section 23,
- If the bid is submitted by mutual collusion pursuant to Sub-section (6) of section 26,
- If the bid is cancelled pursuant to sub-section (7) of section 23.

Evaluation of Bids

Section 25 provides, all submitted bids other than those separated for non-processing pursuant to section 24, shall be included for evaluation. If a bid is found containing minor deviations in the matters such as the technical specifications, descriptions and characteristics etc. so as not to reject the bid, the value of such deviations shall be quantified, to the extent possible, and included in the evaluation of bids. If the value of such minor deviations exceeds 15 % of the bid price of the bidder, such a bid shall be deemed to be substantially non-responsive, and shall be excluded from evaluation. 'Minor deviations' mean such deviations that do not materially depart from the matters such as the technical specifications and descriptions as set forth in the bidding documents.

If invitation to bid has been made after determination of prequalification, the bids submitted by the bidder other than the pre-qualified bidders shall be excluded from evaluation. Bid shall be evaluated in accordance with the criteria and methodology set forth in the bidding documents and in carrying out such evaluation, the bid with the lowest bid price shall be determined by making comparison of the evaluated price of every bid with the evaluated price of the other bids.

The qualifications of the bidder of the bid having the lowest bid price shall be verified in order to ascertain whether it conforms to the qualification criteria set forth in the bidding documents or not. If on examination, the qualification of the bidder of the bid having the lowest bid price is in conformity with the qualification evaluation criteria set forth in the bidding documents, such bid shall be the lowest evaluated substantively responsive bid. If on examination, the qualification of such bidder is found not to be in conformity with the qualification as evaluation criteria set forth in the bidding documents, such bid shall be excluded from evaluation and the qualification of the next bidder having the next lowest bid price shall be examined on the same grounds respectively. The evaluation committee shall prepare an evaluation report stating the criteria and methodology of evaluation of the lowest evaluated substantially responsive bid and submit the report to the Public Entity.

Rejection of Bids or Cancellation of Procurement Proceedings

The Public Entity may reject all bids or cancel the procurement proceedings in the following circumstances:

- If none of the bids are substantially responsive pursuant to clause (d) of sub-section (2) of section 23,
- If it is not able to enter into an agreement with the bidder, despite of the initiation of process of section 27(6),
- If the bid price of the lowest evaluated substantially responsive bid is substantially above the cost estimate, or
- If requisitioned goods, construction works, consultancy services or other services are no longer required.

It further provides that no bid shall be rejected or re-bidding shall be invited only for the reason that only a few bids are or only one bid is substantively responsive. The Public Entity shall have to communicate to all the bidders a notice along with the reason for the rejection of bids or cancellation of the procurement proceedings. Where any bidder requests, within 30 days of the communication of notice, for grounds for the rejection of all bids or rejection of the procurement proceedings, the Public Entity shall have to communicate such information to that bidder.

In making re-invitation to bid because of non-submission of any bid in response to an invitation to bid or cancellation of all bids or cancellation of the bid proceedings, the modification shall also be carried out in the bidding documents, technical specifications, cost estimate and terms and conditions of procurement contract as per necessity by reviewing the reasons for such rejection of bids or cancellation of the bid proceedings. The section further emphasizes that if it is proved that the bidder has submitted bid by collusion among the bidders, such bid shall be rejected.

Acceptance of Bid and Procurement Contract

Section 27 provides that The Public Entity shall select for acceptance only the lowest evaluated substantially responsive bid in accordance with section 25. The Public Entity shall serve a notice of the intent of acceptance of his or her bid to the concerned bidder within seven days of the selection of the bid. Information regarding the name, address of the bidder whose bid has been so selected and the price of the bid shall also be communicated to the other bidders.

If no bidder makes an application pursuant to section 47 within a period of seven days of providing the notice as above, the bid of the lowest bidder as above shall be accepted and a notice shall be communicated to the bidder to furnish the performance security to conclude the procurement contract within 15 days. The bidder shall furnish guarantee of 5% of accepted amount, if he/she has accepted bid up to 15% less as compared to the cost estimates and furnish guarantee of 50% of the amount being more than 15% less as compared to the cost estimates added with 5 % of the accepted amount, if the bidder has accepted bid more than 15% less as compared to the cost estimate.

If the bidder fails to furnish the performance security and sign the procurement contract within the period as mentioned above, the bid security of that bidder shall be forfeited, and the bid of the other immediately next lowest evaluated substantially responsive bidder shall be accepted and the procurement contract concluded.

If even the next lowest evaluated bidder fails to furnish the performance security and sign the procurement contract, the bid of the other immediately next lowest evaluated substantially responsive bidder, respectively, shall be accepted, and a notice shall be served to that bidder for concluding the procurement contract pursuant to this section.

4. PROVISIONS RELATING TO CONSULTANCY SERVICES

A Public Entity may procure consultancy services from any person, firm, organization or company by fulfilling the procedures referred to in this Act in the following conditions:

- If any work cannot be performed by the human resource available at the concerned Public Entity, or
- If a service is required to be obtained from a consultant under the foreign aid source in accordance with an agreement with a donor party.

Preparation of Short List by Soliciting Expression of Interest Openly

If it is required to procure consultancy service that costs more than the prescribed threshold, the Public Entity, in order to solicit expression of interest from the persons, firms, organizations or companies that are interested in providing such consultancy services shall publish a notice in a newspaper of national circulation, giving a period of at least 15 days, setting out the matters as prescribed. The notice may be placed in the website of the concerned Ministry of the Public Entity or of the Public Procurement Monitoring Office.

International level expression of interest shall have to be invited in the following circumstances:

- If the cost of the consultancy service exceeds the prescribed threshold,
- If the consultancy service as requisitioned by the Public Entity is not available under competitive price from more than one consultant within the State of Nepal,
- If no proposal has been submitted in response to invitation to national level proposal for the procurement of consultancy service, and the service has to be procured from any foreign consultant,
- If it is necessary to obtain services from a consultant under the foreign aid source by soliciting international expression of interest in accordance with an agreement with the donor party.

The Public Entity shall, upon evaluation of the qualification, experience and capacity of the intending proponents make selection of generally 3 to 6 intending proponents who can provide such consultancy service, and prepare a short list as prescribed.

If it is required to procure consultancy service the cost of which is less than the prescribed threshold, the Public Entity may prepare a list of the person, firm, organization or company that

can provide such service, by fulfilling the procedures as prescribed, and shall solicit proposals pursuant to Section 31 from the person, firm, organization or company that have been included in that list, by fulfilling the procedures as prescribed.

Soliciting Proposals

Section 31 provides that after a short list has been prepared pursuant to section 30, the Public Entity shall request for proposals from intending proponents, by giving a period of at least 30 days, sending the documents relating to proposal, as prescribed to the intending proponents who are short listed. The documents relating to proposal shall contain the following matters:

- The name and address of the Public Entity,
- The nature of the services to be procured, the time and place when and where the services are to be provided, the terms of reference of the services, the task to be completed and expected outputs,
- Instructions to proponent to prepare proposal,
- Matters that the technical and the financial proposals have to be sealed in separate envelopes, each of which has to clearly indicate the type of proposal outside it and that both envelopes have then to be sealed in a separate envelope and that the required services have to be mentioned thereon,
- Technical and financial evaluation weightage,
- The criteria and weightage marks for the evaluation and comparison of proposal,
- Conditions of the procurement contract,
- The place, date and time for the submission of proposals,
- Method for the selection of proposals,
- Statement that proposals shall not be processed in the event of conflict of interest and information relating to legal action if fraud or corruption is committed,
- Provision that a proponent may make an application for review, against any error or decision made by the Public Entity in carrying out proposal proceedings, and
- Other matters as prescribed.

Opening and Evaluation of Proposals and Cancellation of Procurement Proceedings

After the expiry of the deadline for the submission of proposal, the outer envelope of the proposal received from the proponent shall be opened and the sealed envelope of technical and financial proposal shall be separated.Out of the separated envelope, the technical proposals shall be opened first, and the envelope of financial proposal shall be kept safely apart unopened. The technical proposal shall be evaluated in accordance with the evaluation criteria as prescribed in the documents relating to proposal.

Sub-section (1) of section 35 provides that the envelope of separated financial proposal shall be opened only after making evaluation of the technical proposal. The financial proposals of only those proponents who have been qualified from the evaluation of technical proposals shall be opened. The opened financial proposal shall be evaluated as provided hereunder:

(a) Where quality and cost method is applied to select the proposal, the technical and financial proposals shall be evaluated in a combined form and the proposal of the proponent who obtains the highest marks in such evaluation shall have to be selected as prescribed.

(b) Where quality method is applied to select proposal, only the proposal of the proponent obtaining the highest marks in the technical proposal shall have to be selected.
(c) Where fixed budget method is applied to select proposal, a proposal having cost above such budget ceiling shall be rejected and the proposal of the proponent who obtains the highest technical marks after falling within such budget ceiling shall have to be selected.
(d) Where least cost method is applied to select proposal, the proposal of a proponent having the lowest cost out of the proponents having obtained minimum marks prescribed for being successful in the technical proposal shall have to be selected.

Section 36 of the Act provides provisions relating to rejection of all proposals or cancelation of procurement proceedings in the following conditions:

- If all the received proposals are not substantially responsive to the terms of reference,
- If the cost offered by the selected proponent is substantially more than the cost estimate and available budget,
- If the consultancy service is no longer required or,
- If it is proved that the proponents have submitted the proposal by mutual collusions.

Negotiations with the Proponent & Concluding of Procurement Contract

Section 37 provides that negotiations with the selected proponent may be held in the matter of terms of reference and scope of the proposed services, progress report, and facility to be made available by the Public Entity. Except in conditions under clause (b) of sub-section (1) of section 35, negotiations in relation to financial proposal cannot be held with respect to the remuneration of professional experts. However, negotiations may be held with respect to the reimbursable expenditure.

If an agreement acceptable to both the Public Entity and the proponent could not be resulted from the negotiations held pursuant to this Section, the Public Entity shall have to negotiate in the case of the proposal under clause (a) (b) and (c) of sub-section (1) of Section 35, with the proponent having obtained the next highest marks and in the case of the proposal under clause (d), with the proponent having the next lowest cost, respectively.

Section 38 provides that the proposal of the proponent who has reached to the agreement from the negotiations pursuant to Section 37 shall be selected for acceptance. The Public Entity shall have to serve a notice of the intention of accepting the proposal to the proponent so selected and to other short-listed proponents within 7 days of selection of the proposal.

If no proponent files an application pursuant to section 47 within 7 days of a notice being served, the proposal of the proponent selected pursuant to section 37 shall be accepted and s/he shall be served a notice by giving a period of 15 days to sign the contract.

If the proponent attends within 15 days to conclude contract, s/he shall have to sign contract under Section 52. If s/he does not attend, the Public Entity shall hold negotiations, respectively, pursuant to Section 37 with the proponent having obtained next higher marks in the case of a proponent under clause (a), (b), and (c) of sub-section (1) of section 35 and with the next

proponent having the lowest cost in the case of clause (d) and conclude contract with such proponent pursuant to Section 52.

5. OTHER PROVISION RELATING TO PROCUREMENT

Provision Relating to Sealed Quotation

Rule 84 provides that the Public Entity may as per approved program and procurement plan procure goods, construction works and other services valuing up to two million Rupees by inviting a sealed quotation. Further it also provides that notwithstanding anything mentioned in this Rule, X-ray, ECG, medical goods, and medical equipment valuing up to Rs. 50 lakhs may be procured by inviting sealed quotation.

Before inviting a sealed quotation, a form of sealed quotation stating clearly therein the specifications, quality, quantity terms & conditions of supply & time and necessary matters of the goods, construction work or other services to be procured shall have to be prepared. In inviting a sealed quotation, a notice shall be published in a national or local level newspaper by giving a period of at least 15 days.The sealed quotation, once submitted, cannot be withdrawn or amended.The lowest evaluated sealed quotation falling within the cost estimate after fulfilling the specified terms and conditions shall have to be approved. Other provisions of sealed quotation shall be as prescribed.

Provision for Direct Procurement

Section 41 of the Act provides that notwithstanding anything contained elsewhere in this Act, goods or consultancy services or other services may be directly procured or construction work may be caused to be carried out directly in the following conditions:

(a) Low-value procurement valuing up to the prescribed amount,
(b) If only one supplier or construction entrepreneur or consultant or service provider has the technical efficiency or capacity to fulfill the procurement requirement,
(c) If only one supplier has the exclusive right to supply the goods to be procured and no other appropriate alternative is available,
(d) If additional goods or services of proprietary nature within the prescribed limit is to be procured from the existing supplier or consultant or service provider after it has been proved that if the existing supplier or consultant or service provider is changed to replace or extend existing goods or services or the spare parts of the installed machine the goods or services existing in the Public Entity cannot be replaced or changed,
(e) If procurement is required to be made by one Public Entity from another Public Entity,
(f) If procurement of goods or services is required to be made from international inter-governmental organization at the rate fixed by such organization,
(g) If procurement is required to be made in special circumstances,
(h) If the most necessary construction works, goods or consultancy services or other services within the limit as prescribed but not included in the initial contract due to failure to foresee and difficult to be completed by separating from the initial contract due to technical or financial reasons, is to be procured,
(i) If the service of a particular consultant with his unique qualifications is immediately needed for the concerned work or where the service of same consultant is indispensable.

Procurement to be made pursuant to point (b), (h) and (i) above shall be made in the case of the Public Entity (Constitutional organ or body, Court, Ministry, Secretariat, Commission, Department or government entity or offices of Government of Nepal or Province Government) as per the decision of Government of Nepal, Council of Ministers, on recommendation of the following committee and in the case of other Public Entity as per the decision of the supreme executive body of that entity:

(a) Chief Secretary, Government of Nepal	Coordinator
(b) Secretary, Ministry of Finance	Member
(c) Secretary, Concerned Ministry	Member
(d) Financial Comptroller General	Member

The Public Entity shall invite written rate or proposal from only one supplier or construction entrepreneur or consultant or service provider after preparing a written description as prescribed of the special matter concerning its requirements and quality, quantity, terms and conditions and time of supply and may procure by holding negotiations according to necessity. However, such procurement shall be made only after obtaining prior approval where an approval is required under this Act and by concluding a contract.

Special Provision Relating to Procurement of Ration (Grain)

Notwithstanding anything contained elsewhere in this Act, the Public Entity in procuring ration (grain), shall have to apply the procedure as prescribed in the following matters:

- Cost estimate and approval thereof,
- Price-escalation,
- Bidder's eligibility,
- Bid security,
- Submission of bid, and
- Other matter as prescribed.

Carrying of Works by Users Committee/Beneficiary Community or Non-Governmental Organization

If economy, quality or sustainability is increased in having a construction work carried out or obtaining services related thereto from the users committee or beneficiary community or if the main objective of the project is to create employment and to have the beneficiary community involved, such work may be caused to be carried by or such service may be obtained from a users' committee or beneficiary community by fulfilling the procedure as prescribed (section 44).

If promptness, effectiveness and economy are achieved in having works such as public awareness training, orientation, empowerment, main-streaming carried out by a non-governmental organization, the Public Entity may have such work carried out or obtain such services from a non governmental organization by application of the process as prescribed (section 46).

6. REVIEW OF PROCUREMENT PROCEEDING OR DECISIONS

Filing of Application before the Chief of Public Entity

Section 47 provides that a bidder or proponent may file an application to the chief of the concerned Public Entity for review against any error or decision made by the Public Entity stating the cause for the damages the bidder will suffer or is likely to suffer from the error or breach of the duty, imposed on the Public Entity in carrying out the procurement proceedings or making decision. The application shall be limited with respect only to the proceedings prior to entry into force of the procurement contract. The application shall have to be filed within the period specified, if any, in this Act for making application and, if not so specified, within seven days from the date of the bidder or proponent having become aware of that the Public Entity has made an error or has violated the duty relating to the procurement proceedings. The applicant shall have to state clearly the commission or omission of an act by the Public Entity that led to such error or breach of duty and the provision of this Act or Regulations or guidelines made thereunder that have been contravened by such decision.

If from the inquiry made in respect of the application as mentioned above, an error is found in the procurement proceedings or the Public Entity is found to have breached its duty or such decision is found to be contrary to law, the chief of the Public Entity shall suspend the procurement proceedings and make a decision with reason in writing within 5 days of receipt of such application. The decision shall also state how the procurement proceedings shall further proceed on.

Formation of Review Committee

Section 48 provides, Government of Nepal shall constitute a public procurement Review Committee consisting of the following chairperson and member for review of the application under Section 49:

(a) One person from among the former judges of the High Court or Judge of the High Court or the persons retired from the special class post of Government of Nepal- Chairperson,
(b) One person from among the persons retired from the gazette first class post of the Nepal Engineering Service of the Government of Nepal- Member,
(c) One person from among the persons having experiences and expertise on public procurement- Member

The tenure of the chairperson or members appointed shall be three years and may be extended for another one term. However, in appointing the members for the first time, one member shall be appointed for one year and the other member shall be appointed for 2 years.

The terms and conditions of the service and remuneration and facilities of the chairperson or members shall be as specified by the Government of Nepal. Government of Nepal may remove the chairperson or member in the following conditions:

- If s/he commits misconduct,
- If s/he fails to discharge the functions and duties as per the responsibility of the post due to lack of performance capacity or skill, or
- If s/he is convicted guilty by a court in a criminal offense of moral turpitude.

Section 49 of the Act provides that a bidder or proponent may file an application for review to the Review Committee in the following conditions:

- If the chief of the Public Entity does not make a decision on the application filed before the Public Entity pursuant to Section 47 in respect of the procurement proceedings of the amount above the prescribed threshold within 5 days of receipt of the application or if the applicant is dissatisfied with the decision made by him/her,
- In the matter of the procurement contract concluded pursuant to Section 52.

Rule 103 provides that a bidder or proponent desiring to file an application for review shall have to specify the following matters in the application and sign it:

- Name, address, telephone number, fax number and e-mail address of the applicant,
- If application is to be filed on behalf of a corporate body, document providing authority to so file an application,
- Brief description of procurement proceedings,
- Where procurement contract has already been concluded, date of conclusion of such a contract and the supplier, construction entrepreneur, consultant or service provider who has received such a contract,
- Factual and legal grounds for receiving procurement contract by the applicant,
- Factual and legal grounds for not receiving the contract by the receiver of the procurement contract,
- If the Review Committee has to undertake special measure to protect the proprietary, trade and confidential information of the applicant, such special measures, and
- The actual loss and damages caused to or likely to be caused to the applicant for not having received the contract.

Process of Review

The Review Committee shall notify, by transmitting a copy of such application and document attached to such application if any, to the concerned Public Entity to provide the information about the action taken in that respect and comments thereon within 3 days of the receipt of application for review. The Public Entity shall have to provide to the Review Committee with information and comments related thereto within three days of the receipt of notice.

The Review Committee shall have to make decision within 30 days of receipt of the application on the basis of the information and comments received, the evidence submitted by the applicant along with the application and, if necessary, by hearing both the parties. The Review Committee may make following decisions:

- Dismissing the application,
- In the cases where procurement contract has not been concluded:
  - Giving an order to the Public Entity not to commit or make an unauthorized act or decision or to pursue incorrect procedure,
  - Annulling the whole or in part an unauthorized act or decision made by the Public Entity,
  - If bids or proposals need to be re-evaluated due to occurrence of error in its evaluation, issuing an order for re-evaluation, citing such error as well, if any, in the evaluation.

- Where a procurement contract has already been concluded, if the Review Committee considers that such contract should have been awarded to the applicant, recommending to the Public Entity to pay a reasonable amount (quantum merit) to the applicant having regard to the grievances suffered by the applicant.

An applicant filing application for review shall have to deposit security as prescribed and the security shall be forfeited in case the application is dismissed.

Withholding of Procurement Proceedings

The Public Entity shall have to withhold procurement proceedings until the Review Committee makes a decision in respect of such application. However, procurement proceedings need not be stopped in the following conditions:

- If the Public Entity informs the Review Committee certifying the matter that there is an urgency to keep the procurement proceedings continuing due to an important public interest lying in the procurement proceedings, or
- If the Review Committee fails to make a decision within 30 days of receipt of the application,
- If the procurement contract has been concluded.

7. PROCUREMENT CONTRACT

The Public Entity shall have to conclude a procurement contract in making procurement other than of low-value one, in accordance with this Act. The procurement contract shall include the terms and conditions as referred to in the bidding documents, documents relating to proposal and documents relating to sealed quotation and such terms and conditions may, according to the nature of the contract be the following:

- Name and address, telephone, fax number of the parties to the procurement contract and their contact person for implementation of the contract,
- Scope of the procurement contract,
- Details of the documents included in the procurement contract and their priority order,
- Work performance schedule,
- Supply time, performance time or whether time can be extended or not,
- Procurement contract amount or procedure of determining it,
- Terms and conditions for acceptance of goods, construction work or services,
- Terms and conditions and mode of payment of foreign currency,
- Force majeure,
- If price adjustment can be made, provision thereof,
- If procurement contract can be amended and variation order can be issued, provision thereof,
- If insurance is necessary, provision relating thereto,
- Security required,
- Liquidated damages for failure of performance within the stipulated time,
- Provision concerning bonus to be given if work is completed before the stipulated period,
- Conditions in which procurement contract may be terminated,
- Provision whether sub-contract can be concluded or not,

- Mechanism for settlement of disputes,
- Applicable law, and
- Other matters as prescribed.

Provision Relating to Advance

Section 52A provides that the Public Entity may after entering into a procurement contract, provide advance to supplier, construction contractor or service provider up to 20 % of the value of procurement contract against the submission of a bank guarantee. The distribution of advance shall be half (i.e.10 percent) of the approved advance amount for the first time, and remaining (10 percent) on the basis of work progress.

The vendor is required to commence the work within 30 days from the date of receipt of first advance. The vendor shall prepare particulars of expenses made from the advance money and submit to Public Entity as prescribed. If the advance received pursuant to this section is not found used in the concerned work, the bank guarantee shall be forfeited.

Amendment of Procurement Contract

Section 53 provides provisions relating to amendment of procurement contract. Unless otherwise provide for in procurement contract, a procurement contract may be amended by written consent of both the parties subject to non-alteration of the basic nature or scope of the work. However, procurement contract need not be amended in issuing a variation order pursuant to Section 54 or making price adjustment pursuant to Section 55.

Variation Order

If the circumstances that could not be foreseen at the time of signing of procurement contract arise in the course of implementation of the procurement contract, the following competent authority may, by stating clear reasons thereof, issue a variation order only on the basis of recommendation of experts group formed for the purpose:

Variation Order (%)	Issuing Authority
(a) Up to 5	Gazetted 2nd Class Officer or its equivalent head chief of the concerned public entity. However, if the project cost has been approved by the higher authority, the authority to issue the variation order should also not be lower authority.
(b) Up to 10	Gazetted 1stClass Officer or its equivalent head of public entity. However, if the project cost has been approved by the higher authority, the authority to issue the variation order should also not be lower authority.
(c) Up to 15	Departmental Head.
(d) From 15 to 25	Secretary of Ministry or its equivalent head of the public entity.
(e) Above 25 (for the Public Entities	Council of Ministers, Government of Nepal.

prescribed in sub-clause (1) of clause (b) of section 2)	
(f) Above 15 (for the Public Entities prescribed in sub-clause (2) of clause (b) of section 2)	Supreme Executive Authority. For example, Governor of Nepal Rastra Bank, Managing Director of Nepal Oil Corporation etc.

Price Adjustment in Procurement Contract

Unless otherwise provided in procurement contract, if price needs to be adjusted in the course of implementation of a procurement contract having duration exceeding 12 months, the competent authority may adjust price. However, where a procurement contract has been concluded to procure a public construction work following the invitation of national level bidding and the price of any construction materials is increased or decreased unexpectedly by more than ten percent of the previous price, price shall be adjusted by deducting ten percent in the amount so increased or decreased.

Price adjustment cannot be made in the following conditions:

- If the work under the contract is not completed within the period prescribed in such contract and has taken more time due to the delay by the person who has obtained procurement contract or
- If procurement contract is concluded on the basis of lump sum contract or fixed budget.

Provision Concerning Extension of Contract Period & Payment of Bill or Invoice

The provisions concerning the extension of period of procurement contract shall be as provided in the concerned procurement contract. However, if the period of procurement contract is to be inevitably extended due to force majeure, failure of the Public Entity to make available the materials to be made available by it or other reasonable causes, the competent authority may extend the period on the prescribed grounds upon submission of application by the person obtaining procurement contract.

Termination of Procurement Contract

The procurement contract shall have to specify the grounds in which such contract may be terminated. The main grounds for the termination of the contract may be the following:

- Grounds that the Public Entity may terminate procurement contract if the supplier, consultant, service provider or construction entrepreneur breaches the procurement contract, non-compliance of the code pursuant to section 62(2) or misuse advance money,
- Grounds that the Public Entity may terminate the procurement contract on the grounds of convenience for public interest,
- Grounds that a supplier, consultant, service provider or construction entrepreneur may terminate the procurement contract, and
- Grounds that procurement contract may be terminated for force majeure (beyond control).

A procurement contract shall include the following matters in the event of termination of the procurement contract:

(a) If payment is remaining to be made for the value of work, supply or service that has already been satisfactorily completed, payment thereof,
(b) Liability to be borne by a defaulting supplier, consultant, service provider or construction entrepreneur for the increased cost to be incurred by the Public Entity to carry out or cause to be carried out the work under the procurement contract,
(c) Amount of the actual loss sustained by the supplier or consultant or service provider or construction entrepreneur due to the termination of procurement contract by the Public Entity without any default on his/her part.

Unless otherwise provided in the procurement contract the Public Entity may terminate a procurement contract on the grounds of convenience for public interest. If the contract is terminated on the grounds of convenience, the Public Entity shall have to pay the value for the following work that has been completed prior to the termination of the said contract:
(a) Payment due under point (a) above,
(b) If expenditure is to be paid on reimbursement basis, such expenditure as actually incurred,
(c) The price of the goods specially manufactured for the Public Entity under the procurement contract,
(d) Excluding the lost profit and the amount under point (c) above, the expenditure incurred for termination of the procurement contract, and
(e) Other expenditure as prescribed.

The vendor shall not be entitled to terminate the procurement contract without prior notification to the public entity. If the vendor does not commence work according to contract, abandons work in the middle stage or does not progress work according to contract, the Public Entity may terminate such contract at any time. In case the contract is terminated as such, the guarantee maintained for that purpose shall be forfeited. The Public Entity shall have right to recover the amount from such defaulting vendor as may be required to complete the remaining work in the form of government dues.

8. MISCELLANEOUS

Conduct of the Official Involved in Public Procurement Proceedings

Any officials involved in the act of formulating procurement plan, operating procurement proceedings, implementing procurement contract or other act as prescribed relating to procurement of the Public Entity, shall have to follow the following conduct:
- Discharging one's duty impartially so that bidders fairly compete in the procurement proceedings,
- Operating procurement proceedings in public interest,
- Not committing an act conflicting interest with the procurement from his/her work or conduct or behavior,
- Keeping confidential all proprietary information of the bidder known by him /her in the course of the procurement proceedings,
- Not working with a person, firm, organization, company and any other institution of private nature with which s/he had had dealings of procurement at the time of holding post for two years after retirement,

- If s/he knows that his/her nearest relatives have participated as a bidder or proponent in the procurement proceedings of his/her involvement, not taking part in such procurement proceedings by giving immediate notification to one level higher authority,

  Explanation: For the purpose of this clause nearest relative means husband, wife, father, mother, son, daughter of a joint family, mother-in-law, father-in-law, elder brother, younger brother, elder sister, younger sister, son-in-law, sister-in-law or brother-in-law.
- Not committing an act in contravention of prevailing law, while carrying out procurement proceedings,
- Not committing corrupt or fraudulent practice nor involving in such act,
- Not colluding or involving in a group prior to or after submitting bid or proposal with the objective of forbidding or causing to be forbidden the benefit of competition.

Conduct of Bidder or Proponent

Section 62 provides, a bidder or proponent shall have to accomplish such obligation as referred to in this Act or Regulations made thereunder, procurement contract and other documents relating to procurement. A bidder or proponent shall not carry out or cause to be carried out the following act with the intention of making interference in the procurement process or the implementation of procurement contract:

- Giving or offering directly or indirectly improper inducement,
- Submitting a fact by distortion or misrepresentation,
- Engaging in corrupt or fraudulent practice or involving in such act,
- Intervening in the participation of other competing bidder or proponent to be involved in any way in the proceedings relating to bid or proposal,
- Commit an act of threatening directly or indirectly to cause harm to the body, person or property of any person to be involved in the procurement proceedings or coercive act,
- Making collusion or involving in groupism prior to or after submission of bid or proposal with the objective of allocating procurement contract among the bidders or proponents or fixing the price of bid or proposal artificially or non competitively or otherwise forbidding the Public Entity of the benefit of open and free competition,
- Contacting the Public Entity from the time of the opening of bid or proposal until the notice of acceptance of bid or proposal is given with the objective of causing interference upon bid or proposal or committing an act of interference in the examination or evaluation of bid or in the evaluation of proposal.

A bidder responsible for preparing bidding documents or specifications of a procurement contract or for supervising the implementation of procurement contract or a person or firm or organization or company affiliated with him/her, or an employee working in such firm or organization or company cannot participate in the bidding proceedings of such procurement. However, this provision shall not be applicable in the case of a turnkey procurement contract or procurement contract so concluded as to carryout both the design and construction work.

Blacklisting and Exclusion from the Blacklist

The Public Procurement Monitoring Office may blacklist a bidder, proponent, consultant, service provider, supplier, construction entrepreneur or other person, firm, organization or company in the following grounds from one year to three years on the basis of seriousness of his/her act:

- If it is proved that s/he has committed an act contrary to the conduct as referred to in section 62,
- If a bidder or proponent of a proposal selected for acceptance does not come to sign the contract pursuant to section 27 or 38,
- If it is proved latter that s/he had committed substantial defect in implementing procurement contract or had not substantially fulfilled obligation under the contract or the work carried out according to the procurement contract is not of the quality as per the said contract,
- If convicted from a court of law in a criminal offense liable to be disqualified for taking part in procurement contract,
- If s/he/it is proved of having signed the procurement contract by falsifying qualification or misrepresenting,
- Any other conditions as prescribed.

A bidder, proponent, consultant, service provider, supplier, construction entrepreneur or other person, firm, organization or company blacklisted pursuant as above shall be debarred from taking part in the procurement proceedings of a Public Entity up to that period. A person, firm, organization or company blacklisted by a competent authority under prevailing law for not paying a loan of a bank or financial institution shall not be eligible to take part in the procurement proceeding of a Public Entity during the period of such blacklisting. If such person, firm, organization or company ineligible to take part in the public procurement proceedings is found to have taken part in a procurement of a Public Entity, no action shall be taken over his/her bid or proposal.

Establishment of Public Procurement Monitoring Office

A Public Procurement Monitoring Office under the Office of the Prime Minister and Council of Ministers shall be established in order to monitor, regulate and systematize public procurement system of procurement activities of Public Entity. The chief of the Public Procurement Monitoring Office shall be an employee of the gazetted special class of the civil service of Government of Nepal. The functions, duties and powers of the Public Procurement Monitoring Office, in addition to the ones referred to elsewhere in this Act, shall be as follows:

- To make recommendation to the government of Nepal for reform in the procurement policy or laws in force,
- To issue necessary directives, procedure and technical guidance in the turnkey, E.P.C, structural or unit rate agreement, management agreement related to procurement issues,
- To prepare standard model of the standard bidding documents, prequalification documents, procurement contract document and documents relating to proposal to be used by a Public Entity to conduct procurement proceedings,
- To collect statistics of procurement proceedings to be operated by a Public Entity and to monitor or examine whether or not such proceedings are conducted in compliance with this Act or Regulations or manual, made thereunder,

- To review or cause to be reviewed after procurement works,
- To prepare records of qualification or experience of construction traders, suppliers, and consultant relevant to procurement.
- To issue digital procurement guideline,
- To provide opinion and advice if the Public Entity seeks opinion and advice about a matter as referred to in this Act or Regulations, manuals made thereunder,
- To establish and operate procurement website,
- To publish a bulletin in order to have made public this Act and the Regulations, Manuals, Technical Notes made thereunder and public procurement related writings, article, material and similar other matters,
- To prepare procedures required for coordination in the procurement proceedings and submit to the Government of Nepal for approval,
- To make arrangements for regular training program for the bidder or the employee involved or to be involved in procurement proceedings,
- To make necessary criteria of exclusion from the blacklist under Section 63 and exclude from such blacklist as per such criteria,
- To review, appraise construction works, supply, consultancy service, and other services system in order to make the procurement system effective, and to solicit regularly suggestion from customers or international organization and other foreign bodies as per necessity,
- To prepare plan of domestic or foreign assistance required to systematize and reform procurement system and to act as the central body for coordinating such assistance,
- To certify or cause to certify procurement expert,
- To submit the annual report of the procurement proceedings to the Government of Nepal,
- To do other prescribed functions.

If the procurement proceedings of the Public Entity is found against this Act or the Rules or procedures or guidelines made under this Act, the Public Procurement Monitoring Office (PPMO) shall write to draw attention of the Chief of the Public Entity to make correction in the procurement proceedings and levy punishment as per prevailing law to the official involved in procurement proceedings. If chief of the Public Entity is found involved in such procurement proceedings, it shall write to the concerned authority to draw attention. If such information is received in writing, the Chief of the Public Entity or the concerned authority shall make correction in the procurement proceedings and impose punishment to the concerned official and provide information to the Public Procurement Monitoring Office.

Non-applicability of Procurement Process Under This Act

The procurement process under this Act need not be applied in the following conditions:

(a) If the Government of Nepal decides that procurement relating to security, strategic or defense by application of the process in accordance with this Act is not appropriate for the interest of national security or defense,
(b) If as per the agreement between Government of Nepal and donor party, procurement is to be made in accordance with the Procurement Guidelines of a donor party,
(c) If goods or services are required to be procured by prescribed Public entities which compete with private sectors for business,

(d) If procurement as prescribed is required to be made in the foreign country for social, cultural, program or industrial, economical, technology expo and promotion in the trade fair or exhibition organized in the foreign country,
(e) If goods or services are required to be procured by Nepalese Embassy or Mission situated in foreign country,
(f) If Public Entities licensed to operate aviation service are required to procure aviation or equipment relating to aircraft.

In making a decision pursuant to point (a) above, Government of Nepal shall have to state reasons for procurement and determine separate procedure related thereto as well. The Public Entity for the purpose of procurement mentioned in point (c), (d), (e) and (f) above shall make necessary procedures and implement it by obtaining approval of Public Procurement Monitoring Office. The Public Entity shall for the purpose of procurement mentioned in point (f) above, include business plan, life cycle and net present value in the procedures.

Formation of Evaluation Committee

The Public Entity shall have to form an evaluation committee as follows for examination and evaluation of the pre-qualification proposals, bids, expression of interest or proposals of consultancy services or sealed quotation:

(a) The chief of the Public Entity or a senior officer designated by him (a technical staff as far as possible) - Chairperson
(b) Chief of the Financial Administration Section of the concerned Public Entity - Member
(c) Technical expert concerned with the subject matter (officer level as far as possible)- Member
(d) Legal officer of the concerned Public Entity, where such a position exist - Member

Chief of the procurement unit shall act as the- Secretary of the committee.

The evaluation committee may, with approval of the chief of the Public Entity, invite in its meeting the special expert in the subject matter of governmental or non-governmental sector. If the committee requires the assistance of a consultant, the Public Entity may, subject to the approved program and budget, appoint a consultant by application of the procedure set forth in the Act and this Regulation. The committee may form a sub-committee for rendering assistance to it in the work of evaluation of quotation, bid or proposal. The secretary of the evaluation committee shall have to prepare and keep the minute of the meeting and keep a file of all the agenda discussed in the meeting. The evaluation committee itself may determine its procedure.

Records of Procurement Proceedings

A Public Entity shall have to maintain a separate file for each procurement proceedings. The following documents shall be filed in the file (Rule 149):

- Register of contract file,
- Notice for invitation to bid or prequalification,
- Documents relating to invitation to bid, pre-qualification or proposal,
- Request made by the bidder for clarification with respect to bidding documents, prequalification documents or proposals; and the answers sent by the Public Entity in respect thereof to all participating bidders or proponents,

- Minute of the pre-bidding conference held with the bidder or consultant and the evidence of the Public Entity having sent the copy of such minute to all participating bidders or proponents ,
- Minute of opening bid,
- Original copy of the bid,
- Questions asked to the bidder or proponent by the bid evaluation committee in the course of bid evaluation and the answers sent by the concerned bidder or proponent to the Public Entity,
- Report on the evaluation of qualifications of the pre-qualified bidder,
- List of the pre-qualified bidders,
- If negotiations were held, minute thereof,
- Copy of the preliminary notice of the acceptance sent to the successful bidders,
- Copy of the notice sent to the unsuccessful bidders,
- All notices published in respect of procurement,
- Application filed before the chief of the Public Entity and the Review Committee and the opinion, comment and information submitted by the concerned Public Entity in respect thereof and decision made over it,
- Procurement contract,
- Documents relating to implementation of procurement contracts such as progress report, invoice and inspection report,
- If the procurement contract is amended, document relating thereto,
- Documents concerning receipt, inspection and also acceptance of goods,
- All correspondences made with the construction entrepreneurs, supplier, consultant or service provider, as the case may be,
- Request made by sub-contractor and the answer given by the Public Entity in respect thereof,
- Evaluation report and all documents relating thereto,
- Documents relating to the proceedings carried out to resolve the dispute relating to procurement contract.

The above records shall be kept safely up to at least seven years of the completion of the procurement proceedingsconfirmation. The records under this Rule shall be kept in the format specified, if any, by this Regulation, if it is not so specified, in the format as specified by the Public Procurement Monitoring Office. In keeping the records, the Public Entity shall have to keep records of every physical property. In keeping the records of physical property, if the value of the property exceeds five million rupees, the records shall state the details of such property along with its cost price, depreciation and maintenance cost.

Procurement in Special Circumstances

If the occurrence of special circumstance has created a situation in which, if a procurement is not made immediately, the Public Entity will sustain further loss, the Public Entity may procure or cause to be procured immediately. The chief of the Public Entity shall have to give information of the above circumstances and the detailed description concerning the procurement to be made immediately to one level higher authority. Other provision concerning procurement to be made in special circumstances shall be as prescribed.

Method of Communication

Any document, notice, decision or other information as referred to in this Act and Regulations made thereunder, bidding documents, documents relating to request for proposal or procurement contract as to be given by the Public Entity to a bidder, consultant or by a bidder or consultant to the Public Entity shall, unless otherwise provided for in this Act, be given in writing.

In case where a notice transmitted as above, could not be served due to failure to trace out the address of the recipient bidder or consultant or for any other reason, a public notice shall be published in a daily newspaper of national level circulation stating therein brief description thereof and where a notice is so published such person shall be deemed to have received the notice.

CHAPTER- 15

AUDIT ACT, 2075 (2019)

1. INTRODUCTION

The Audit Act, 2075 is enacted to make necessary provisions on audit, mostly concerned with the audit of government bodies andoffices and to make laws relating to audit time bound. It was promulgated on 15th Chaitra, 2075 by replacing the previous Act of 2048 (1991). Accounts audited under the Audit Act, 2048 shall be deemed to have audited under this Act. The audit commenced according to Audit Act, 2048 and not completed before the commencement of this Act shall be conducted in accordance to this Act.

In this Act, following terminologies are defined as follows:
(a) Audit: "Audit" means examination of the accounts and the analysis and evaluation made on the basis thereof of the entity mentioned in section 3 and this term also includes reexamination.

(b) Corporate body wholly owned by Government of Nepal, Provincial Government or local level: "Corporate body wholly owned by Government of Nepal, Provincial Government or local level" means a corporate body whose all shares or assets are owned by Government of Nepal, Provincial Government or local level or a corporate body whose all shares or assets are owned by the aforesaid corporate body or by such corporate body and Government of Nepal, Provincial Government or local level and this expression shall also include such corporate body for which Government of Nepal, Provincial Government or local level is required to bear full responsibility.

(c) Corporate body: "Corporate body" means a corporate body whose more than 50 % shares or assets are owned by Government of Nepal, Provincial Government or local level and this expression shall also include a corporate body whose more than 50 % shares are owned by the corporate body.

(d) Government office: "Government Office" means Office of president, Office of vice president, supreme court, federal parliament, Provincial assembly, Provincial government, Office of Provincial Chief, Constitutional bodies or their offices, , Court, Office of Attorney General, Nepal Army, Nepal Police, Armed Police Force, Nepal, all government offices of Federal, Province and local level.

Entities to be Audited by Auditor General

Sub-section (1) of section 3of the Act provides that following entity shall be audited by Auditor General:
(a) Government Office,
(b) Corporate body wholly owned by Government of Nepal, Provincial Government or local level,
(c) Body or entity prescribed to be audited by Auditor General pursuant to Federal laws.

The responsible officer of the entities mentioned above shall submit accounts of income and expenditure and financial records pursuant to the prevailing law to the Auditor General for final audit.

Methods of Audit

The Auditor General may conduct final audit of the financial activities and other activities relating thereto of the Entities mentioned in section 3(1) or units under such entities either in detail or sporadically or a random basis and present the facts obtained therefrom, make critical comments thereon and submit its reports.

Types of Audit

(a) Financial Audit and Miscellaneous Audit

The Auditor General, with due regard to the regularity, economy, efficiency, effectiveness propriety and other essential aspects, shall along with financial audit of the entities mentioned in section 3(1), conduct information technology, performance, gender, environment audit and miscellaneous audit etc. The method, process, scope of audit and reporting of miscellaneous audit shall be as prescribed by the Auditor General.

(b) Concurrent Audit

The Auditor General may conduct concurrent audit of the entities mentioned in section 3(1) before completion of the fiscal year or after completion of the transaction. The method, process, scope of audit and reporting of concurrent audit shall be as prescribed by Auditor General. The Auditor General shall submit audit report to the concerned entity and publish the report.

(c) Subsidy and Grant Audit

The Auditor General may conduct audit of any subsidy and grant to be received by Government of Nepal, Provincial Government or local level and subsidy or aid received from Government of Nepal, Provincial Government or local level according to federal laws. The method, process, scope of audit and reporting of subsidy and grant audit shall be as prescribed by Auditor General.

Matters to be Audited

The Auditor General, with due regard to the regularity, economy, efficiency, effectiveness propriety and other essential aspects, shall audit following matters to as certain:

- Whether or not the amount appropriated in the concerned heads and subheads by the Appropriation Act or other Act for respective services and activities have been expended for the specified purposes of designated services or activities within the approved limit,
- Whether or not the accounts have been maintained in the prescribed forms and such accounts fairly represent the position of the transactions,
- Whether or not the constitutional entity, Ministry, Department or Central level offices of same standing have maintained central accounts relating to appropriation, revenue or deposit of offices under its jurisdiction,
- Whether or not the accounts of Federal Reserve Fund, Provincial Reserve Fund, Local Level Reserve Fund, Federal Emergency Fund, Provincial Emergency Fund and other government Fund are maintained properly,
- Whether or not the concerned Government Entity has released the budget in time,

- Whether or not the financial statements depict the true picture of the financial transactions of the period,
- Whether or not there is sufficient evidence to prove income and expenditures in different heads,
- Whether or not there is physical improvement according to accounts or reports,
- Whether or not the expenditures are authorized from the authorized person,
- Whether or not the incurred liability has been paid in time,
- Whether or not optimum utilization has been made of tangibles, resources and assets,
- Whether or not proper records of government assets have been maintained,
- Whether or not proper preservation and maintenance of government assets have been done to avoid loss,
- Whether or not proper system of accounting exists for the recording of government loan or investment and interest paid or received or dividend received from such loan or investment or whether or not accounts have been maintained,
- Whether or not there is sufficient legal provisions and control to avoid misuse of expenditures,
- Whether or not there is sufficient internal control system,
- Whether or not internal audit has been carried out effectively and if conducted effectively, whether or not implementation of the report has been done,
- Whether or not amount to be deposited in the revenue or government fund has been ascertained according to law, recovered, deposited and recorded and whether or not effort has been taken to prevent revenue leakage,
- Whether or not there is adequate legal provisions relating to security and whether or not it has been abided,
- Whether or not there is adequate provisions relating to accounting of income or expenses of industrial or professional services,
- Whether or not there is sound and effective organizational structure, management and work division, and whether or not operation and management has been carried out accordingly,
- Whether or not any function is being unnecessarily performed in duplication by any employee or agency or any essential function is being omitted,
- Whether or not the progress has been achieved within scheduled time and the quality and quantity of the work is satisfactory,
- Whether or not the objective and policy of the Office is explicit and the program is delineated conforming to the specified objective and policy,
- Whether or not the program is being implemented within the limits of approved cost estimate and the proceeds received in comparison to the cost is reasonable,
- Whether or not the arrangements for maintaining data relating to target, progress and cost are adequate and reliable,
- Whether or not monitoring has been done according to prevailing laws and the findings of the monitoring report has been implemented,
- Whether or not effort has been taken to convert financial transactions, records and reports into management information system,
- Whether or not proper utilization and mobilization of the revenue, aid and royalty allocated pursuant to prevailing laws to the Government of Nepal, Provincial Government or local level has been done,

- Whether or not settlement work has been carried out in time,
- Whether or not reconciliation has been done in time.

Matters to be audited in View of Propriety

The Auditor General shall audit following matters considering the propriety thereof:

- On the propriety of any expenditure and its authorization, if in the opinion of the Auditor General such expenditure is a reckless one or is an abuse of national property, whether movable or immovable, despite that the expenditure confirms to the authorization.
- On the propriety of all authorizations issued in respect of any grant of national property whether movable or immovable, fixed or current, or underwriting of any revenue, or any contract, license or permits relating to mining, forest, water resources, etc. and any other act of abandoning movable or immovable, assets of the nation.
- On the propriety of public construction, repair and maintenance, procurement and supply, contract relating to consultancy service, service contract, public expenditure and mobilization of resources.

The Auditor General may examine whether the officials under his jurisdiction has borne financial responsibility or not if deemed necessary on the basis of acceptable principles of audit. The Auditor General may not include in the report minor items of discrepancy and other items deemed as insignificant in view of their propriety which were observed during the audit of income and expenditure.

Audit of Corporate Bodies Wholly Owned by Government of Nepal, Provincial Government or Local Level

Clause (b) of sub-section (1) of section 3 provides that the audit of 'corporate body wholly owned by Government of Nepal, Provincial Government or local level' shall be conducted by Auditor General. However, the Auditor General may appoint license holder auditors under the prevailing laws an assistant as per necessity. The auditor appointed as assistant shall act under the direction, supervision and control of the Auditor General. The powers, functions, duties and responsibilities of the auditor appointed as assistant and the procedures to be followed by him in the course of audit and provisions relating to their report shall be as prescribed in the Act, and in the matters not prescribed in the Act, it shall be as prescribed by the Auditor General. The remuneration to be paid by the concerned organization to the auditor appointed as assistant shall be fixed by the Auditor General keeping in view the volume of financial transactions, status of accounts, number of branches and sub-branches, work load and work progress of the concerned organization.

Audit of Corporate Bodies

Corporate bodies shall appoint auditors and conduct audit in accordance with the principles prescribed by Auditor General. The Corporate bodies shall consult Auditor General while appointing the auditor. The concerned organization shall deliver at the Office of the Auditor General a copy of the report submitted by the appointed auditor. The Auditor General may issue directives to the concerned organization and the auditor in respect of the irregularities observed in the report. It shall be the duty of concerned organization and the auditor to abide by such

directives. The concerned corporate body shall submit to the Auditor General the implementation progress report of the directives within the period prescribed by Auditor General.

Power of the Auditor General to Examine or Demand Documents

The Auditor General may ask the responsible officer of the entities mentioned in section 3(1) to submit documents relating to accounts and seek information relating to it from the concerned officer at any time. The Auditor General may, if it deems necessary exercise the following powers:

- To check at any time the status of the program and project being operated under the grants obtained by Government of Nepal, Provincial Government and Local level and examine documents relating to accounts,
- To require contractors of government contracts to produce relevant documents or other evidence relating to the contract, which are supposed to be in his/her possession, and to require to submit additional documents to ascertain revenue in relation to the revenue audit,
- To require to submit documents relating to operation of entities partially owned by Government of Nepal, Provincial Government or Local Level and non-governmental organization or international non-governmental organization.
- To have access to management information system relating to operation of transactions, keeping of accounts, record management or information dissemination of the entities mentioned in sub-section (1) of section 3.

Annual Report of the Auditor General

The Auditor General shall include the following matters in its annual audit report to be submitted to the President according to Article 294 of the Constitution of Nepal, 2072:

(a) Particulars of wok performed by the Auditor General during the year,
(b) Major summaries observed by the Auditor General,
(c) Implementation status of Audit report and reforms to be made in future,
(d) Other necessary matters.

The Auditor General may issue audit report along with the recommendations to the entity mentioned in section 3(1) after the completion of the audit. The Auditor General may submit report on information technology, performance, gender, environment and concurrent audit of such entity. The Auditor General may prepare separate report on working procedures of each Province and submit to the concerned Provincial Chief. The report shall be presented in the Province Assembly by Chief Minister.

If there is huge loss to movable or immovable national property or such loss may incur if immediate action is not taken, Auditor General may conduct audit of such transactions at any time and submit report to the President or Provincial Chief.

Audit of Local Level

Every Rural Municipality and Municipality shall be audited by Auditor General. Auditor General may submit separate report after the completion of audit of every Rural Municipality

and Municipality. The concerned Rural Municipality or Municipality shall present the report submitted by the Auditor General in the Rural municipal assembly or Municipal assembly pursuant to the prevailing local level laws for discussion.

Implementation of Audit Report

It shall be the responsibility of the concerned responsible officer to implement the report of the Auditor General issued pursuant to this Act. The Auditor General may obtain information on whether or not improvements has been made in the areas specified in the report issued under this Act and whether or not recommendations of the Auditor General has been implemented. It may also obtain report from the entities of which audit has been performed regarding the actions taken by the entity, seek information, prescribe time for its implementation, make re-examination and issue necessary directives.

Power of the Auditor General to Issue Directives

The Auditor General may, subject to the Constitution of Nepal, and this Act, issue directives from time to time to the concerned entity to make provisions relating to accounts and to maintain regularity therein. The Auditor General may, subject to the Constitution of Nepal, and this Act, issue directives from time to time to the concerned regulatory body entrusted for auditing services. The Auditor General may issue directives from time to time to the Auditor appointed under this Act for audit of Government offices and corporate bodies on the matters of subject of audit, matters to be included in the report and on matters included in the report. It shall be the duty of the concerned offices and officers to abide by the directives issued under this section.

Power of the Auditor General to Write for Punishment

The Auditor General may write to the concerned entity for departmental action as well as other punishment pursuant to prevailing laws against any responsible officer or person who does not conduct audit pursuant to this Act, provide financial statements or accounts to the auditor appointed pursuant to section 10 and 11, submit documents relating to audit pursuant to section 12 and submit notice and information relating to it, maintain account in the format specified in section 23 or make obstruction in the audit process, and violates this Act or the Rules made under this Act. The concerned entity shall punish the concerned officer or employee as soon as possible and provide information to the Office of the Auditor General.

Review of Audit

The auditor General may for the purpose of ensuring quality of audit conducted under this Act make provision of review of audit or peer review on a periodic basis. The review of audit shall not be conducted by any person or entity other than as review prescribed under this section.

Hiring Service of Expert

Auditor General may hire services of any expert in the concerned field for the completion of any work. The Auditor General may request to depute and provide service of any expert or officer working in any entity of Government of Nepal, Provincial Government or Local Level for the assistance of any work to be conducted by him/her. The concerned entity shall depute and make available service of expert or officer if it is requested by the Auditor General. The Auditor

General shall provide remuneration or facilities as prescribed to the expert providing service or to the deputed expert or officer.

Office of Auditor General

The Auditor General may, as per necessity, establish office in the provinces and federal level for the completion of work to be undertaken by him/her. The employees deputed in such offices shall work in the direction of the Auditor General. The organizational structure and human resource requirement of the office of Auditor General shall be as approved by the Government of Nepal on the recommendation of Auditor General.

Punishment for discrepancy

The concerned entity shall punish according to law in respect of any discrepancy found during the audit of income or expenses or other headings of Government of Nepal, Provincial Government or local level.

Format of Accounts

The accounts of transactions of government offices shall be maintained in the format approved by Auditor General. It shall be the responsibility of the Office of Comptroller General to approve and implement or cause to implement the format.

Powers to Frame Rules and Issue Standard or Directives

Auditor General may in consultation with the Government of Nepal, frame Rules for the implementation of this Act. The Rules shall be effective from the date published in the Nepal Gazette. The Auditor General may subject to this Act or the Rules framed under this Act, issue and implement International Auditing Standards, Auditing Standards or directive on the basis of good practice to make audit reliable and trustworthy and enhance quality of audit.

CHAPTER- 16

ARBITRATION ACT, 2055 (1999)

1. INTRODUCTION

Conceptual Framework

Arbitration is a more formalized process resulting in a binding award that will be enforced by courts of law in many countries. Arbitration is a normal process where dispute emerged between parties is resolved outside the established court by the legally appointed person or an institution under the consensus of the parties. Arbitration is a means of settling disputes otherwise than by court action and it arises when one or more persons are appointed to hear the arguments submitted by the parties and to give decision on them. When dispute arises during the progress of a contract, it is not necessary that it should automatically go before a court of law for resolution. The parties involved may agree to submit their differences to a third party in whom they have confidence and whose decision they will accept and enforce. To resolve a dispute in this manner, without recourse to the courts, is the essence of arbitration. Therefore, arbitration is a means or technique or method or way or manner or mechanism to resolve the commercial type of disputes by neutral expert called arbitrator out of the courts.

Arbitration Act, 2055 has not defined the word arbitration but it defines 'agreement' means a written agreement reached between the concerned parties for a settlement by arbitration of any dispute relating to any specific legal issue that has arisen or may arise in the future as under a contract or not (section 2a of Arbitration Act, 2055). Where two or more persons agree that a dispute or potential dispute between them shall be decided in a legally binding way by one or more impartial persons in a judicial manner, that is upon evidence put before him or them, the agreement is called an arbitration agreement or a submission to arbitration. When, after a dispute has arisen, it is put before such person or persons for decision, the procedure is called arbitration, and the decision when made is called an award.

Historical development of Arbitration Laws in Nepal

The history of laws and experiences of arbitration has not so long in context of Nepal. Arbitration is one of the most important methods of Alternative Dispute Resolution (ADR) in commercial sector. There are various ways to settle the disputes through out of the courts; i.e. arbitration, mediation, negotiation conciliation, trial, etc. In this modern business age, arbitration is becoming famous.

The formal legal history of arbitration law in Nepal dates back to the year 1957 AD. When the amendment made in the Act inserted a provision of arbitration in case where the development board is involved with. After introducing arbitration by giving room in the Act, a trend has been established to recognize arbitration as a means of settling disputes in other Acts subsequently. Such Acts binding the system for settling disputes via arbitration are Nepal Airlines Act, 1962 AD, Commercial Act, 1974 AD and so on. Before promulgating the special law relating to arbitration, there were scattered legal provisions in relation to the settlement of disputes through method of Alternative Dispute Resolution (ADR), i.e. arbitration and mediation in several Acts.

The Nepalese Arbitration Law acquired the precise and formal recognition of lawmakers in 2038 through the enactment of the Arbitration Act, 2038 (1981). It was the Act which was wholly concentrated with the arbitration. After being existed for approximately 18 years, now the Act

has been replaced by Arbitration Act, 2055 (1999), which is the prevailing law of Nepal to this effect. The Act was promulgated on 2nd Baisakh, 2056.

In this Act, following terminologies are defined as follows:

(a) Agreement: "Agreement" means a written agreement reached between the concerned parties for a settlement through arbitration of any dispute concerning any specific legal issue that has arisen or may arise in the future under a contract or otherwise. The concerned parties shall be deemed to have entered into a written agreement in case any of the following documents exists:

- Any contract containing provision for arbitration or any separate agreement signed in that connection.
- Letter, telex, telegram or telefax message, or any other similar message exchanged through telecommunication media whose records can be maintained in a written form, between the concerned parties which provide for referring their disputes to arbitration.
- In case any party has presented a claim for referring any dispute to arbitration and the objection to that claim submitted by the party objecting to that claim without rejecting the proposal for referring the dispute to arbitration.

(b) District Court: "District Court" means the District Court of the place prescribed in the agreement as the place of arbitration, if any, and if no such place has been prescribed, the place where the dispute has arisen or where the arbitration proceedings have been conducted and decisions taken, or the territorial jurisdiction over the place where any party generally resides.

(c) High Court: "High Court" means the High Court of the place prescribed in the agreement as the place of arbitration, if any, and if no such place has been prescribed, the place where the dispute has arisen or where the arbitration proceedings have been conducted and decisions taken, or the territorial jurisdiction over the place where any party generally resided.

(d) Counter-claim: "Counter-claim" means a claim made by the Respondent on the Claimants.

(e) Rejoinder: "Rejoinder" means a claim to the counter-claim by the Claimants.

Section 3 of the Act provides that in case any agreement provides for the settlement of disputes through arbitration, the disputes connected with that agreement or with issues coming under that agreement shall be settled through arbitration according to the procedure prescribed in that agreement, if any, and if not, according to this Act. In case of concerned parties to a civil case of a commercial nature which has been filed in a court and which may be settled through arbitration according to prevailing laws, file an application for its settlement through arbitration, such dispute shall also be settled through arbitration.

Appointment of Arbitrators

Section 6 provides that except as otherwise contained in the agreement, the process of appointing arbitrators shall be started within 3 months from the date when the reason for the settlement of a dispute through arbitration arises. If the agreement mentions the names of arbitrators, they themselves shall be recognized as having been appointed as arbitrators. If the agreement has

made any separate provision for the appointment of arbitrators, arbitrators shall be appointed accordingly. Except as otherwise contained in the agreement, each party shall appoint one arbitrator each and the arbitrators shall appoint the third arbitrator who shall work as the chief arbitrator.

Section 7 provides provisions relating to appointment of arbitrators by Court. Any party may submit an application to the High Court for the appointment of arbitrators explicitly mentioning the full name, address, occupation and the field of specialization of at least three persons who can be appointed as arbitrator, and also be accompanied by a copy of the agreement in the following circumstances:

- In case no arbitrator can be appointed upon following the procedure contained in the agreement.
- In case the agreement does not mention anything about the appointment of arbitrators.

Upon receiving of an application, the High Court shall notify all the parties and shall appoint arbitrators from the persons proposed by them in the case of consensus in that connection, and in the case of failure to consensus, the persons deemed appropriate by the High Court within 60 days from the date of receipt of the application. The decision taken by the court shall be final.

Section 8 provides provisions relating to fulfillment of Arbitrators in special circumstances. In case appointed arbitrator for the purpose of arbitration falls vacant by reason of his/her resignation or refusal to function in that capacity or of his/her death or any other reason, it shall be filled up by appointing another arbitrator ordinarily within 30 days from the date when the vacancy has occurred in the manner in which the arbitrator had originally been appointed. In case of vacant arbitrator cannot be filled up within this time limit, any party may apply to the High Court within 15 days from the date of expiry of the time limit. In case such an application is filed, the High Court shall appoint an arbitrator ordinarily within 15 days subject to section 7.
The number of arbitrators shall be as specified in the agreement. In case the agreement does not specify the number of arbitrators, there shall ordinarily be 3 arbitrators. In case the number of arbitrators appointed under the agreement is even, it shall be turned into odd by designating an additional arbitrator chosen by them.

Disqualifications of Arbitrators

The following persons shall be disqualified for appointment as arbitrators:

- Disqualified for entering into contracts as per prevailing laws,
- Punished by a court on criminal charges involving moral turpitude,
- Become insolvent or been declared bankrupt,
- Any personal interest in the dispute which has to be settled through arbitration,
- Not having any specific qualification specified in the agreement for becoming eligible for appointment as an arbitrator.

Removal of Arbitrators

The condition and procedure for removal of an arbitrator shall be as mentioned in the agreement. In case the condition and procedure has not been mentioned in the agreement, any party may, in

any of the following circumstances submit an application to the arbitrator requesting for permission to remove an arbitrator within 15 days from the date of his/her appointment or from the date when the party learns that the concerned arbitrator has failed to act:

- In case any arbitrator is clearly seen to have shown a bias toward or discriminated against any party instead of working in an impartial manner,
- In case any arbitrator engages in improper conduct or commits fraud in the course of arbitration,
- In case any arbitrator frequently commits mistakes or irregularities in the course of arbitration,
- In case any arbitrator does not attend arbitration meetings or refuses to take part in arbitration proceedings for more than three times without furnishing satisfactory reasons with the objective of prolonging or delaying the arbitration proceedings in an improper manner,
- In case any arbitrator takes any action which is opposed to the principles or rules of natural justice, or
- In case any arbitrator is found to be lacking the necessary qualifications, or to have ceased to be qualified.

Upon receipt of application as above, the arbitrator whose removal has been demanded does not relinquish (resign) his/her post voluntarily, or other party does not agree with grounds of his/her removal, the arbitrator shall take a decision on the matter within 30 days from the date of application. A complain may be filed before the High Court against such decision, and the decision of the High Court shall be final.

Location of Office of the Arbitrator

The office of the arbitrator shall be located at the following place:

- At the place specified in the agreement, if any.
- If the agreement does not specify the location of the arbitrators office, at the place selected by the concerned parties.
- In case the concerned parties do not select such place within 15 days from the date of appointment of the arbitrator, or in case the concerned parties fail to reach an agreement in that connection, at the place specified by the arbitrator in the light of all the relevant circumstances.

Notwithstanding anything mentioned above, the arbitrators may, except when any other arrangement has been made by the concerned parties, designate through mutual consultations the location of their office at any other appropriate place which is convenient for them to record the statements of witnesses, obtain the opinion of experts, and inspect any document, object or place.

2. ARBITRATION PROCEEDINGS AND POWERS OF ARBITRATORS

Submission of Claims, Counter-Claims, Objections or Rejoinders

Section 14(1) of the Act provides that the claimant shall submit its claim to the arbitrator within the time limit mentioned in the agreement, if any, and within 3 months from the date when a

dispute requiring arbitration has arisen in case only the name of the arbitration has been mentioned in the agreement without mentioning any time limit, and from the date of appointment of arbitrator in case arbitrator has been appointed after the dispute has arisen. Such claim shall be submitted in writing explicitly mentioning the details of the subject matter of the dispute and the remedy sought, along with evidence, and also supply a copy thereof to the other party. Sub-section (2) provides, after a claim is filed, the other party shall submit its objection to it within 30 days from the date of receipt of the claim, unless otherwise provided for in the agreement.

The other party shall submit its objection, as well as its counter claim, if any, in that connection within 30 days from the date of receipt of the claim, unless otherwise provided for in the agreement. If it submits a counter-claim also, the arbitrator shall provide a time limit of 15 days to claimant to submit its rejoinder over such counter-claim. If a rejoinder is so submitted a copy thereof shall be supplied to the party making the counter claim. While submitting claims, counter-claims, objections or rejoinders, all documents as well as evidence proving them, if any, shall also be submitted. Each party submitting documents to the arbitrator in connection with arbitration proceedings under this Act shall supply copies thereof to the other party. If the parties wish to prove any point through witness, they must mention the full name and address of such witnesses in their claims, counter claims, objections or rejoinders, and they shall themselves be responsible for presenting such witnesses before the arbitrator on the day prescribed by him/her.

In case any party fails to submit its objection, or rejoinder within the time as mentioned above due to circumstances beyond his/her control, it may submit an application to the arbitrator for an extension of the time limit within 15 days from the date of expiry of the time limit, explicitly mentioning satisfactory reasons for its failure to do so. The arbitrator may extend the appropriate time limit as requested in the application if he/she finds the reasons mentioned in the application to be satisfactory.

Circumstances in Which Arbitration Proceedings Shall Terminate or Continue

Arbitration proceedings shall terminate or continue in the following circumstances, except when otherwise provided for by the parties:

- The arbitration proceedings shall terminate in case the claimant does not submit his/her claim within the time limit mentioned in Section 14 (1).
- Even if no objection is submitted within the time limit mentioned in section 14 (2), this alone shall not be taken as the acceptance by the party not submitting its counter-claim to the claim made by the claimant, and the arbitrator shall continue proceedings in such a manner as to evaluate the claimant's claim and the evidence submitted to substantiate the claim.
- The arbitrator may pronounce the verdict on the basis of the evidence that has been submitted or in case any party does not present itself or does not submit any written evidence at the time of hearing prescribed by the arbitrator. Arbitration shall send a copy of the verdict to the party not submitting its objection as well.

Power of the Arbitrator to Determine Jurisdiction

In case any party claims that the arbitrator has no jurisdiction over the dispute that has been referred to him/her for settlement, or that the contract because of which the dispute has emerged

is itself illegal or null and void, he/she may claim so before the arbitrator. The arbitrator shall take a decision on his/her jurisdiction or the validity or effectiveness of the contract before starting the proceeding on the matter referred to him/her. For the purpose of taking a decision on the validity or effectiveness of a contract pursuant, in case the contract contains provisions for the settlement of disputes through arbitration as its integral part, such provisions shall be taken as a separate agreement, and even if the arbitrator takes a decision holding the contract as null and void, such provisions shall not be held to be legally null and void for that reason alone.

Any party not satisfied with the decision taken as above may file an appeal with the High Court within 30 days from the date of decision, and the decision taken by the high court on the matter shall be final. The filling of a petition with the High Court shall not be deemed to have prejudiced (hampered) the power of the arbitrator to continue the proceedings and pronounce the decision before the petition is finally disposed of by the court.

Procedure to be Adopted by Arbitrators

Arbitration proceedings shall be held in confidentiality, except when otherwise desired by the parties. The procedure to be adopted by the arbitrator while taking a decision on a dispute shall be as mentioned in the agreement, and in case no such procedure has been mentioned in the agreement, it shall be as laid down in this Act. However, procedure not laid down in the Act shall be as prescribed by the arbitrator with the consent of the parties, and in case the parties fail to reach an agreement in that connection, it shall be as prescribed by the arbitrator him/herself.

The arbitrator shall start arbitration proceedings immediately after receiving all such claims, objections, counter-claims or rejoinders as need to be received by him/her. The arbitrator shall inform the parties about the type of proceedings to be held, and the day and time fixed for the purpose and also keep records thereof in the concerned case file.

The arbitrator may continue arbitration proceedings and pronounce his/her decision on the basis of the available evidence even if any party does not present on the day and at the time of arbitration proceedings after receiving a notice. After the completion of the process of hearing, the arbitrator shall issue an order with the effect that the hearing has concluded and keep a record thereof in the case file. No evidence may be examined or the parties heard thereafter.

Except as otherwise mentioned in the agreement, the arbitrator shall read out his/her written decision within 30 days from the date of issue of an order as above and shall ordinarily be within 120 days from the date of submission of documents under section 14. In respect to a dispute which has been referred to three or more arbitrators, the arbitrators who are present may conduct all arbitration proceedings other than taking the final decision or issuing the final order.

Substantive Law to be Followed by Arbitrators

The Nepal Law shall be the substantive law to be followed by the arbitrator, except when otherwise provided for in the agreement. The arbitrator may settle the dispute according to the principle of justice and conscience (*Ex aqua et bono*) or natural justice (amiable compositor) only when explicitly authorized by parties to do so. Notwithstanding anything contained

elsewhere in this act, the arbitrator shall settle the dispute according to the conditions stipulated in the concerned contract. While doing so, arbitrator shall also pay attention to the commercial usages applicable to the concerned transaction.

Powers of the Arbitrator

Except when otherwise provided for in the agreement, the powers of the arbitrator shall be as follows:

(a) To direct the concerned parties to appear before him/her to submit documents, and record their statements as required,
(b) To record statements of the witness,
(c) To appoint expert and seek their opinion or cause examination on any specific issue,
(d) To obtain a bank guarantee or any other appropriate guarantee as determined by the arbitrator, in case party is a foreign national so that the decision pronounced by the arbitrator is not likely to be implemented for that reason,
(e) To inspect concerned place, object, product, structure, production process or other related matter which are connected with the dispute on request of parties or on his/her own initiative if he so deems appropriate, and in case there is any material or object which is likely to be destroyed or damaged, to sell them in consultation with the parties, & keep sale proceeds as a deposit,
(f) To exercise any specific power conferred by the parties,
(g) To issue preliminary orders, or interim or inter locating orders in respect to any matter connected with the dispute on the request of any party, or take a conditional decision,
(h) To issue certified copy of document,
(i) To exercise the other power conferred by this Act,

Any party which is not satisfied with the order issued by the arbitrator pursuant to point (g) above may submit an application to the High court within 15 days, and the decision made by the High Court shall be final.

Situation in Which Arbitration Decisions Shall Not Be Taken

In case any issue requiring arbitration is found to be inextricably linked with any other issue on which the arbitrator cannot pronounce the decision, the arbitrator shall not pronounce decision on that issue. In a situation in which the arbitrator cannot take a decision, the arbitrator shall inform the concerned parties accordingly. Notwithstanding anything contained in the prevailing law, the concerned party may file a complaint to the court within 35 days from the date of receipt of such information.

Decision of Arbitrator

Section 26 of the Act provides that in case there are three or more arbitrators, the decision of the majority shall be deemed to be the decision of arbitration. In case the arbitrators have dissenting opinions so that the majority (opinion) cannot be ascertained, the opinion of the chief arbitrator shall be deemed to be the decision of arbitration, except when otherwise provided for in the agreement. Every arbitrator shall affix signature on the decision. However, in case there is any special reason that any arbitrator cannot affix signature on the decision, the other arbitrators shall

affix their signatures explicitly mentioning the reason. In case any arbitrator does not agree with the decision of arbitration, he/she may express his/her dissenting opinion.

Section 27 provides that the arbitrator shall explicitly mention the following matters in the decision, except when otherwise provided for in the agreement:

- Brief particulars of the matter referred to for arbitration.
- In case any party had questioned jurisdiction of arbitration, grounds for deciding that matter falls under jurisdiction of arbitration.
- The arbitrator's decision, and reasons and grounds for reaching that decision.
- Claims that must be realized or amounts that must be compensated.
- Interest on amount to be realized, and the additional rate of interest to be charged after the expiry of the time limit for implementing the decision of the arbitrator in the event of the expiry of the time limit mentioned in section 31.
- Place and date of decision.

Decision to be Read Out

The arbitrator shall read out the decision in the presence of the concerned parties, hand over a copy of that decision to each party, and keep evidence thereof in the case file. In case any party is absent at the time fixed for reading out the decision or refuses to accept a copy of the decision even after being present at the time fixed for reading out the decision, a notice shall be furnished to him/her along with a copy of the decision after indicating the same.

Prohibition to Revision of Decision

Section 29 provides that except the High Court has issued an order under Section 30, the arbitrator shall not take another decision on the matter referred to him/her for arbitration after once reading out his decision on the matter, except correcting arithmetic, printing, typing or similar other minor errors and inserting omitted particulars without prejudice to the matter of the decision.

In case any party observes that any mistake contained in the decision of the arbitrator needs to be corrected as above he/she shall submit an application to the arbitrator within 30 days from the date of receipt of a copy of the decision. In case the arbitrator deems it appropriate to correct such mistakes or insert any omitted particulars, he/she may prepare a separate note thereof and have the omitted particulars inserted or mistakes corrected within 15 days from the date of receipt of the application. In case the arbitrator deems it appropriate to make such correction, he/she shall do so by preparing a note thereof and informing the parties accordingly within 30 days from the date of decision.

Notwithstanding anything mentioned elsewhere in this section, in case the arbitrator has not taken a decision on any point from among the points contained in the claims made by any party, the concerned party may submit an application for a decision on the point to the extent of the matter covered by it after securing the approval of the other party within 30 days from the date of decision by the arbitrator. In case such an application is received, a supplementary decision may

be taken by confining in to the matter covered by the point within 45 days from the date of application.

If the parties so agree, any party may, by notifying the other party, request the arbitrator to explain any point contained in or any part of the arbitrator's decision which is not clear within 30 days from the date of decision. In case any such request is received, the arbitrator may explain and clarify any unclear point within 45 days.

Invalidation of Decision of Arbitration

Any party dissatisfied with the decision taken by the arbitrator may, if he/she wishes to invalidate the decision file a petition to the High Court along with related documents and a copy of the decision within 35 days from the date decision heard or notice received thereof under this Act. The Petitioner shall also supply a copy of that petition to the arbitrator and the other party.

In case a petition is filed as above, the High Court may invalidate that decision or issue an order to have a fresh decision taken as per necessity in case the petitioner proves that the arbitration decision contains any of the following matters:

- In case any party to the agreement was incompetent for any reason to sign the agreement at the time of signing the agreement, or in case the agreement is not valid under the law of that nation which governs jurisdiction over the parties, or in case such law is not clear and agreement is not valid under the laws of Nepal.
- In case the petitioner was not given a notice to appoint an arbitrator or about the arbitration proceedings in due time.
- In case the decision has been taken on a disputed matter that had not been referred to the arbitrator, or in a manner contrary to the conditions prescribed for the arbitrator, or by acting beyond the jurisdiction prescribed for the arbitrator.
- Except when an agreement has been signed contrary to laws of Nepal, in case procedure of designation of arbitrators or their functions and actions do not conform to agreement signed between parties, or in case there is no such agreement it has not been done as per this Act.

The High Court may also invalidate the decision of the arbitrator in case the dispute settled by the arbitrator cannot be settled through arbitration under the laws of Nepal or in case the decision taken by the arbitrator is likely to be prove detrimental to the public interests or policies.

Implementation of Award (Decision)

Section 31 provides provisions relating to award (decision) of arbitration proceedings. The concerned parties shall be under obligation to implement the award of the arbitrator within 45 days from the date they receive a copy thereof. In case an award cannot be implemented within this time limit, the concerned party may file a petition to the District Court within 30 days from the date of expiry of the time limit prescribed for that purpose to implement the award. In case such a petition is filed, the District Court shall implement the award ordinarily within 30 days as if it was its own judgment.

Section 34 provides provisions relating to implementation of award taken in a foreign country in Nepal. A party willing to implement an award (decision) taken in a foreign country in Nepal shall submit an application to the High Court along with the following documents:

- The original or certified copy of the arbitrator's award.
- The original or certified copy of the agreement.
- In case the arbitrator award is not in the Nepali Language, an official translation thereof in Nepali language.

In case Nepal is a party to any treaty which provides for recognition and implementation of decisions taken by arbitrators in foreign countries, any decision taken by an arbitrator after the commencement of this act within the area of the foreign country which is a party to that treaty shall be recognized and implemented in Nepal in the following circumstances:

- In case the arbitrator has been appointed and award made according to the laws and procedure mentioned in the agreement.
- In case the parties had been notified about the arbitration proceedings in time.
- In case the decision has been taken according to the conditions mentioned in the agreement or upon confining only to the subject matters referred to the arbitrator.
- In case the decision has become final and binding on the parties according to the laws of the country where the decision has been taken.
- In case the laws of the country of the petitioner or the laws of the country where arbitration proceedings have been conducted, do not contain provision under which arbitration award taken in Nepal cannot be implemented.
- In case the application has been filed for the implementation of the award within 90 days from the date of award.

In case the High Court is satisfied that the conditions mentioned above have been fulfilled in the application, it shall forward the award to the District court for its implementations.

The section further provides that no award made by an arbitrator in a foreign country shall be implemented in Nepal in case the awarded settled dispute cannot be settled through arbitration under the laws of Nepal and in case the implementation of the award is detrimental to the public policy.

3. MISCELLANEOUS

Payment of Interest

Except when otherwise provided for in the agreement, in case the arbitrator has taken an award providing for the payment of any amount by one party to another, the concerned party shall also pay interest at the rate prescribed by the arbitrator in the light also of the nature of the business related to the dispute and by ensuring that it is not higher than the rate of interest currently charged by commercial banks in respect to similar transactions. However, no interest shall be charged for the period between the date of decision by the arbitrator and the time limit prescribed for the implementation of the award under this Act.

Cost of Arbitration Proceedings

Except when otherwise provided for in the agreement, parties seeking arbitration shall pay to the arbitrator the amount fixed in consultation with parties for conducting the proceedings. Except otherwise provided in the agreement, each party shall bear expenses required for the proceedings in proportion prescribed by arbitrator taking into account relevant circumstances.

Arbitrator's Remuneration

The arbitrator's remuneration shall be as prescribed in the agreement. In case the arbitrator's remuneration is not prescribed in the agreement, the concerned parties shall pay the remuneration fixed by arbitrator in consultation with them.

Devolution of Rights and Liabilities

In case any party dies, disappears or becomes insane after the commencement of arbitration proceedings under this Act, all his rights and liabilities shall devolve on his/her heir who is entitled to inherit his/her property pursuant to the prevailing law.

Parties may Compromise

In case the parties to a dispute that has been referred for arbitration under this Act desire to reach a compromise, they may submit an application to the arbitrator explicitly mentioning the conditions under which they wish to do so. The arbitrator shall approve the application so filed, and no appeal may be filed against such award except on issues concerning actions not taken according to the condition for compromise.

Documents Relating to Arbitration

The arbitrator shall prepare a case file of the document, evidence, statement of the concerned persons award and all other documents connected with arbitration mentioning date and time in a chronological order. After the finalization of the arbitration proceedings, the arbitrator shall submit the concerned case file to the District Court. The District Court shall keep the case file as safely as it keeps the case files of its judgments. No copy of the award & documents related thereto shall be given to any person other than concerned parties without their approval.

Court to Have No Jurisdiction

Notwithstanding anything contained in the prevailing law, no court shall have jurisdiction over any matter regulated by this Act, except when otherwise provided for in this Act.

CHAPTER- 17

BANKING OFFENSE & PUNISHMENT ACT, 2064 (2008)

1. INTRODUCTION

Banking offense is such unauthorized acts that make losses to banking system. It is simply known as banking fraud. Bank fraud is the use of potentially illegal means to obtain money, assets, or other property owned or held by a financial institution, or to obtain money from depositors by fraudulently posing as a bank or other financial institution. In many instances, bank fraud is a criminal offense. Unauthorized act against the banking law is called banking offense and fraud. While the specific elements of particular banking fraud laws vary depending on jurisdictions, the term bank fraud applies to actions that employ a scheme or artifice (trick), as opposed to bank robbery or theft. For this reason, bank fraud is sometimes considered a white-collar crime.

Normally banking offences are categorized into two parts as follows:

(a) Internal Risk Factors: This includes activities such as misreporting of positions, employees/directors wrong acts, insider trading, etc.

(b) External Risk Factors: Activities such as robbery, forgery, cheque fraud, hacking, etc.
Banking offenses (fraud) may be carried out by bankers, Board of Directors, valuators, banking clients, etc. in the operation of banking business. Banking offense full activities are outlined as below:

- Misuse of authority,
- Misuse of credit,
- Unauthorized withdrawal and payment,
- Abuse of electronic means,
- Wrong valuation (excess, low),
- Violation of banking norms and rules,
- Wrong report preparation,
- Alteration of BFIs accounts or making fraud, forgery in account,
- Misuse of banking means, resources and property,
- Unauthorized act against the interest and right of depositors and shareholders,
- Unwilling to pay and repay interest, principles or charges, etc.

An Overview of Banking Offense & Punishment Act, 2064

Banking Offense and Punishment Act, 2064 was promulgated on 23rd Magh, 2064 with the objective to provide legal provisions on banking offences and punishments, to promote the trust of general public towards banking and financial system and to mitigate the consequences and the risks that the banking and financial system may suffer on account of the offences that may be occur in course of transactions of banks & financial Institutions.

Banking Offenses

The Chapter has laid down different series of activities that are considered as offense under the Act. It has also emphasized the persons liable for the offenses. The different series of activities are as follows:

Not to open an Account or Demand Cash Payment in an Unauthorized Manner [Sec. 3]:

While opening an account with a bank or financial institution or demanding cash payment, no one shall undertake the following acts:

(a) Open or knowingly allow to open an account by submitting false documents,
(b) Open or allow to open an account in the name of a fictitious or other person or organization, except otherwise permitted by the laws,
(c) Draw a cheque to obtain payment from an account where he/she has an apparent knowledge that the account does not have sufficient balance to cover the amount of the cheque drawn.

Not to Make Unauthorized Withdrawals or Payments [Sec. 5]:

While withdrawing or making payment from an account maintained with a bank or financial institution, no one shall: Withdraw money in an unauthorized manner from other person's account. Also, no one shall transfer fund in an unauthorized manner from customer's account or make unauthorized payment there from.

Not to Obtain or Make Payment by Way of Abuse or Unauthorized Use of Electronic Means [Sec. 6]

No one shall obtain or make payment by way of abuse or unauthorized use of a credit card, debit card, automated teller machine (ATM) card or other electronic means.

Not to Avail or Provide Loans in an Unauthorized Manner [Sec. 7]

While availing or providing loans from a bank or financial institution, no one shall commit the following acts:

(a) Avail or provide loans by submitting a false, fake or unreal financial statement or by creating artificial business.
(b) Avail or provide excess loans by way of unnatural over valuation of collateral security.
(c) Avail or provide loans by way of unnaturally hiking the project cost based on false details.
(d) Avail or provide credit, facility or discounts beyond the authority obtained or limit sanctioned.
(e) Avail credit or advance facilities by Chief Executive Officer or employees of the bank or financial institution other than the loan or facilities provided according to prevailing employee by rule from his/her bank or financial institution.
(f) Avail credit by promoter, director, shareholder deemed to have financial interest pursuant to prevailing laws or his/her family member from his/her bank or financial institution. Provided that restriction shall not be made to avail credit against the security of fixed deposit receipt, gold or government securities.
(g) Re-avail or re-provide loans from or by other Bank of Financial Institution without having due release of the collateral security once provided to a Bank or Financial Institution. However, this restriction shall not be applicable in case of release of loans to be provided under consortium lending under paripassu agreement up to the value covered by the collateral.
(h) Avail loans through an entity having established in the name of a person who, in fact, does not have financial capability to run the business or, who is a person under undue influence or

establish business in the name of such person or provide credit in the name of person by creating false burrower or extend or obtain loans knowing the said facts.

(i) Extend credit more than the requirement compared to the customer's business transaction.
(j) Accept or provide any sort of undue benefit in return to granting credit facility.
(k) Obtain full or partial credit facilities by the promoter, director, chief executive officer or person responsible to sanction credit of bank or financial institution by approving credit in the name of false customer with the intent of utilizing credit facilities.
(l) Supply credit facilities in the name of person or institution having financial interest of promoter, director, chief executive officer or person responsible to sanction credit.

Not to Misuse Credit [Sec. 8]:

No one shall misuse the credit facilities availed from a bank or financial institution or let the same be misused by diverting in the purpose other than for which the credit facilities were availed.

Not to Misuse Banking Resources, Means and Assets [Sec. 9]:

The promoter, director, shareholder who is deemed to have a financial interest under the prevailing laws, Chief Executive Officer, employee, advisor, Managing Agent or associated person or organization or family member or close relatives of such persons shall not misuse the resources of a bank or financial institution by availing a credit or facility or in any other manner. However, It shall not be deemed to be an obstruction in availing loans or advances by the Chief Executive Officer or employees of a bank or financial institution under employees' facility scheme, as per the prevailing laws. Further, It shall not be deemed to be an obstruction in providing credit or facility to close relative having approval of the Board of Directors of Bank or Financial Institution.

Explanation:

(a) For the purpose of this Sub-section, the term "family member" means concerned person's husband or wife, son, daughter, adopted son, adopted daughter, father, mother, step mother and taken cared elder brother, younger brother and elder sister younger sister.

(b) *"Close relative" means separated elder brother, younger brother, elder sister in law (wife of elder brother), younger sister in law (wife of younger brother), married elder sister, younger sister, elder brother in law (husband of elder sister), younger brother in law (husband of younger sister), nephew (son of uncle), niece (daughter of uncle), younger brother in law (wife's younger brother), younger sister in law (wife's younger sister), mother in law (wife's mother), father in law (wife's father), uncle, aunt, maternal uncle, maternal aunt, nephew (son of sister), Niece (daughter of sister), grandson, granddaughter, granddaughter in law (wife of grandson), grandson in law(husband of granddaughter).*

No one shall, in violation of the interest of the depositor/s or a bank or financial institution, expense the assets of the bank or financial institution or let the same be incurred. It also emphasizes that no one shall commit any financial irregularity, whiling auctioning or selling the

non banking assets or other assets of a bank or financial institution or while doing any other transactions.

Not to Acquire Assets or Open Account by Borrower who has Over Dues [Sec. 10]:

No borrower who has over dues and is in black list shall remit money to a bank by opening an account with a local or foreign bank or financial institution or continue such account or operate the account or purchase any movable or immovable assets in any manner or acquire title or possession over such assets in any manner without settling the dues payable to a bank or financial institution.. *However,* account may be opened for the purpose of repayment of loan or deposit of money in the account up to 30 days and make payment of loan by cheque. The borrower may withdraw amount from account situated in Nepal or foreign country for daily basic life maintenance up to the prescribed limit.

Not to Stop Credit Facility in the way to Loss Working Project of Borrower [Sec. 11]

Bank or Financial Institution which has once provided the first installment after approving credit facility for a project of borrower, without sufficient basis and considerable reason, shall not stop the remaining installments in-between in the way to loss working project of the borrower.

Not to Make Loss by Making Alteration in Account or Ledger or by Committing Forgery or Fraud [Sec. 12]

No one shall, with a motive of self-benefit or to cause loss or benefit to any other person, commit any forgery by action like tempering any matter written in Bank or Financial Institution's document or account or ledger whether by removing or by re-writing the same to mean different sense or with a motive to loss other, commit fraud by misleading others representing the untrue or non-existent facts to be true or existent or by getting a document signed with an alteration in the date, number or particular.

Not to make any Fraudulent Activities to BFIs and Cooperatives [Sec. 12A]:

(a) No one shall make loss to the assets of bank or financial institution or cooperative institution or association or by fraud or cohesion with other person/s or make forged documents relating to the rights of such property.
(b) No one shall make loss to the bank or financial institution or cooperative institutions by acquiring or concealing cash, fund, securities or other movable or immovable assets of the bank or financial institution or cooperative institutions.
(c) No one shall make loss to the bank or financial institution or cooperative institutions by making fraudulent transaction for own benefit.

Not to Derive Excess, Low or False Valuation or Prepare False Financials [Sec. 13]:

While carrying out the valuation of movable or immovable assets held by a bank or financial institution as a collateral security of a loan or non-banking movable or immovable asset of a bank or financial institution, the valuator shall not derive excess, low or false valuation of such assets while valuating for the purpose of auctioning sell or for other purpose relating to Bank. Moreover, the valuator shall not carry valuation of property of any person or institution in which he/she has financial interest.

No person, firm or company or institution shall prepare or cause to prepare separate financial statements for a particular date or period for the purpose of availing credit. Auditor shall not certify different financial statements for the same date or period to be submitted by any person or institution to Government of Nepal, foreign donor agency or other entity without disclosing his/her opinion.

Not to Carry Out and Cause to Carry Out Irregular Economic and Financial Transactions [Sec. 14]:

No one shall, with a motive to cause any harm loss to a bank or financial institution, get something done or undone or bargain or forbid bargaining or take or give any amount or take or give any goods or services free of costs; take or give any charity, grant, gift or donation; execute or get executed or translate or get translated a false deed or do work or get the work be done with an ill intention to cause illegal benefits or losses.

Not to Carry out Dhukuti Transactions [Sec. 14A]:

No one shall carry or caused to be carried out Dhukuti transactions. For the purpose of this Act, "Dhukuti Transaction" means transaction of raising fund from each other and taking or providing loan on rotations on the basis of mutual understandings.

Not to Carry out Banking Transactions in an Illegal Manner [Sec. 14B]:

Cooperative society or union registered under Cooperative Act, 2074 shall not carry or caused to be carried banking or financial transactions without obtaining license from Nepal Rastra Bank.

2. PUNISHMENT AND MISCELLANEOUS PROVISIONS

Punishment

- If any person commits any offense specified under clause (a), (b) or (c) of Section 3: Recover the claim amount, fine as per claim amount and imprisonment up to 3 months.
- If any person commits any offense specified under Section 11:

Such person shall be punished with recover of the claim amount, fine as per claim depending upon the degree of offense committed.

- If anyone commits any offense specified under Section 5, 6 or clause (d), (d1), (d2), (e), (f), (g), (h) (i) or (j) of Section 7, Section 8, 9, 10, 12 or section 14, he/she shall be punished with fine and imprisonment as stipulated under on the basis of the claimed amount, after recovering the claimed amount, if any and depending upon the degree of the offense committed:

Claim Amount	Imprisonment	Fine	Compensation
Up to 10 lakhs	Up to 1 year	As per claim Amount	As per claim amount
10 -50 lakhs	2- 3 years	As per claim Amount	As per claim amount
50 -100 lakhs	3-4 years	As per claim Amount	As per claim amount
100- 1000 lakhs	4-6 years	As per claim Amount	As per claim amount
1000-5000 lakhs	6-8 years	As per claim Amount	As per claim amount

5000 lakhs- 1 Arab	8-10 years	As per claim Amount	As per claim amount
Above 1 Arab	10-12 years	As per claim Amount	As per claim amount

- If any person commits any offense specified under clause (a), (b) or (c) of Section 7 or section 13: Recover the claim amount, fine as per claim amount and imprisonment up to 4 years.
- If anyone commits any offense specified under Section 12a, 14a and 14b, he/she shall be punished with fine and imprisonment as stipulated on the basis of the claimed amount, after recovering the claimed amount, if any and depending upon the degree of the offense committed:

Claim Amount	Imprisonment	Fine	Compensation
Up to 50 lakhs	Up to 1-3 year	As per claim Amount	As per claim amount
50 -500 lakhs	3- 5 years	As per claim Amount	As per claim amount
5 -50 crore	5-7 years	As per claim Amount	As per claim amount
Above 50 crore	7-9 years	As per claim Amount	As per claim amount

- In case the suit amount cannot be established in accordance with this Section, he/she shall be punished with a fine up to Rupees one million and an imprisonment up to two years depending on the offense committed.
- In case any organization commits any offense specified under this Act and if the concerned office bearer or the employee committing such offense be identified, he/she shall be held liable, if the office bearer or the employee could not be identified, the person working in the capacity of the organization head at the time of the occurrence of the offense shall be held liable.
- Assistance to commit crime, he/she is punished as half of main offender.
- If offense pursuant to section 3, 5, 6, 7, 8, 9, 10, 11, 12, 12A, 13, 14, 14A and 14B is committed by chairman, director or CEO, he/she shall be imprisoned for an additional 1 year along with the prescribed years of imprisonment.

Punishment to the Persons Creating Hindrance

If anyone creates hindrance protest in the investigation and inquiry proceedings undertaken under this Act, the adjudicating officer may punish him/her with an imprisonment up to six months or a fine up to five thousand rupees or both based on the report of the Officer involving in Investigation and inquiry.

Time and Limitation for the Lodgment of First Information Report

In regard to an offense under this Act, first information report (FIR) may be lodged within one year from the date the offense comes to the knowledge and the suit shall have to be lodged within six months from the date the first information report (FIR) is so lodged with the Court as prescribed by the Government of Nepal by publishing a notice in Nepal Gazette. However, a law suit may, at any time be initiated against an employee or office-bearer of a bank or financial institution, who caused misappropriation or loss of asset of Bank or Financial Institution during his/her assumption of service in any post thereof and there shall be no obstruction in initiating a lawsuit even after such office-bearer or employee retires from his/her service.

In the lawsuits, where punishment shall be given as per this Act, the government shall be the plaintiff and such lawsuits shall be considered to be included in Schedule-1 of Act relating to Muluki Criminal Procedure(Code)Act, 2074.

Delivery of Notice

Notwithstanding anything contained in the prevailing laws, a notice to be delivered in the name of a foreign individual, in connection with the offenses under this Act, shall be delivered in the name of an office or representative of such individual in Nepal, if any, and the notice so delivered shall be deemed to be duly delivered. In case such office or representative is not existent, the notice shall be delivered at the main business place of such individual or his/her permanent residential address or at the mailing address if provided by him/her during the course of business, through telex, telefax or other means of recordable telecommunication or through post by registration and the notice so delivered shall be deemed to be duly delivered. However, if there is a separate provision in any treaty where Government of Nepal or Nepal is a party, there shall be no obstruction in delivering the notice in the name of a person residing in foreign country in the manner as specified in the same.

Adjudication Proceedings and Disposal of the Case not be Affected

Notwithstanding anything contained under the prevailing laws, the adjudication proceedings and disposal of the case initiated or to be initiated pursuant to this Act shall no longer be affected even after the death of the offender.

CHAPTER- 18

AN ACT RELATING TO INSTITUTIONS ACTING AS FINANCIAL INTERMEDIARY, 2055

1. INTRODUCTION

Banking offense is An Act Relating to Financial Intermediary Act, 2055 was promulgated on 17th Chaitra 2055. The Act came into force on 15th Jestha 2065. The Act is promulgated with the objectives to provide for societies working as financial intermediaries for the collection of micro savings and supply of micro credit on an institutional basis to low income people living in different parts of the country so as to involve them in micro enterprises and thus improve their economic condition.

In this Act, Financial Intermediation means the collection of micro-saving and supply of micro-credit under thisAct. Society means a Society registered under the Associations Registration Act, 2034(1977) and licensed to work as a 'financial intermediary' under this Act. Bank means the Nepal Rastra Bank established under the Nepal Rastra Bank Act, 2058. Micro enterprise means an income oriented enterprise operated with less than 10 persons. Low income person means a person with an income lower than the income prescribed by the Nepal Rastra Bank from time to time.

Requirement of License to Work as Financial Intermediary

After the commencement of this Act, no one shall work or instigate others to work as a financial intermediary without obtaining a license under this Act.

In case any society which has been registered under the Associations Registration Act, 1977 with the objective of working as a financial intermediary desires to work as a financial intermediary under this act, it shall submit an application to the Bank in the prescribed format explicitly mentioning the following particulars:

(a) Certificate of registration and Constitution of the Society.
(b) Names, addresses and occupations of office bearers of the Society.
(c) Total number of members of the Society.
(d) Movable and immovable assets of the Society.
(e) Geographical area where the Society wishes to work as a financial intermediary.
(f) Other matters as prescribed.

On Receipt of an application as above, the Bank shall conduct necessary inquiries into it, and, if it so deems necessary in the course of such inquiries, it may demand additional information or particulars from the applicant-Society

In case the Bank so deems appropriate in the course of conducting inquiries, it shall collect the prescribed fee and issue to the applicant in the prescribed form a license to work as a financial intermediary within not more than 75 day, from the date of receipt of the application, or of the additional information or particulars demanded, if any.

Renewal of License

A Society shall have its license renewed by the Bank every two years in the prescribed manner. Any License which is not renewed within the mentioned time limit shall be *ipso facto* cancelled.

Application shall be given to the bank for the renewal of the license received by the institution every two years within forty five days before the expiry of the time of the license along with the following documents:

(a) Annual report as per section 32 of the Act and other financial detail as mentioned by the bank.
(b) Certified photocopy of renewal of registration certificate of the society as per Associations Registration Act, 2034.
(c) Details for any change made in management, objective, work jurisdiction etc of the institution.
(d) Voucher presented in the bank against the registration charge Rs 100.
(e) Other necessary things as directed by the Bank.

While applying for the renewal of license, if the Bank feels that the conditions and direction given from time to time are not complied with by the institution, such license can be cancelled or renewal of the license may not be done.

Functions, Duties and Power of Societies

The Functions, duties and powers of a Society, in addition to those mentioned elsewhere in this act, shall be as follows:

(a) To encourage low-income persons to form groups,
(b) To collect micro savings from groups or group members,
(c) To supply micro credit to any group or member thereof for operating an micro enterprises, with or without any movable or immovable property as collateral or guarantee,
(d) To obtain loans or grants from Government of Nepal or the Bank or any local or foreign organization or association, and use them for the supply of micro- credit or for making the process of supplying such credit effective,

"Provided that, it shall be mandatory for a Society to secure the approval of Government of Nepal through the Bank before obtaining loans, grants or any other type of assistance from any foreign organization, association, etc."

(e) To evaluate schemes for which micro- credit have been requested, and determine whether or not they are feasible, before supplying micro-credit,
(f) To organize publicity and extension programs about income and employment oriented programs of the type which help to improve the economic condition of low-income persons,
(g) To organize workshops on income and employment oriented enterprises, extend help and provide training in the formulation of schemes, make available technical know-how, and mobilize technical assistance according toneed.
(h) To Provide necessary services to group in respect to the micro-savings and mobilization of micro-credit,
(i) To take necessary actions for the timely realization of micro-credit.
(j) To conduct investigations from time to time to determine whether or not micro credit has been properly utilized and if it is not found to have been properly utilized, to issue necessary directives or taking necessary action,

(k) To perform all such functions as are prescribed in connection with the collection of micro savings and the supply of micro credit,

(l) To work as an agent of commercial banks and financial institutions,

The society has to act through the elected committee of the members of the society. The rules provide as follows for the constitution and function of the committee:

Agreements to be Signed

While supplying micro-credit, a Society shall execute a written agreement with the borrower by prescribing conditions deemed essential for the protection and proper utilization of the credit.

While executing an agreement as above, the Society may prescribe any time limit for repayment of its micro-credit, or a condition to the effect that it may have the borrower repay the principal and interest if he violates the conditions prescribed by it, or to recover the same from the collateral pledged or collective guarantee furnished by the borrower. Provided that, a Society shall not accept the security furnished by any person not connected with the concerned group while obtaining a security from the borrower.

Power of Societies in the Event of Breach of Conditions [Sec. 11]

(1) In case any borrower fails to abide by the agreement signed or terms stipulated with a Society, or to repay the micro-credit of a Society within the time limit stipulated in the bond, or in case a Society finds through investigations that the borrower has misused or misappropriated the amount of micro-credit, the Society may notwithstanding anything contained in prevailing law, auction any property pledged to it, or any security deposited with it, according to prevailing law, and thus recover the principal and interest.

(2) In case any borrower relinquishes in any manner title to the property pledged to a Society as collateral, or the value of such collateral declines due to any reason, the Society may, notwithstanding anything contained in prevailing law, ask him to furnish additional collateral which is sufficient to cover the credit within the period prescribed by it. In case the borrower fails to furnish additional collateral within the time limit prescribed by the Society, the Society may recover its principal and interest by auctioning the collateral pledged to it.

(3) In case the principal and interest cannot be fully recovered through the auction sale of the collateral pledged to the Society under Sub-Section (1) or (2), the Society may recover the balance by auctioning the other assets of the concerned member in case any member of a group has obtained the micro-credit on an individual basis, and of all the members of the group in case the micro-credit has been obtained on a collective basis.

(4) The amount of principal and interest and expenses incurred in auction shall be deducted from the amount raised through the auction of the assets under this Section, and the balance amount shall be refunded to the concerned person.

(5) In case no one offers a bid in an auction held by a Society under this Section, the concerned Society may itself take over the ownership of such assets.

In case the bid offered by anyone is approved in the course of auctioning the assets pledged as collateral, or in case a Society itself takes over the ownership of such assets on the ground that

no one offered a bid in an auction, the Society shall write to the concerned Land Revenue Office for registration or transfer in its records according to prevailing law of the concerned assets in the name of the person whose bid has been approved or in the name of the Society.

In case the concerned Land Revenue Office receives a written request from any Society for registration or transfer of assets as above, it shall do so accordingly.

Power to Determine Interest Rates and Collect Service Charges

A society shall itself determine the interest rates to be paid and charged by it on micro savings and micro credit subject to the policy and directives of the Rastra Bank. It must furnish information about the same to the Bank within seven days. However, the Bank may, if it so deems necessary, direct the Society to increase or reduce the interest rates fixed by it and it shall be the duty of the Society to comply with such directives.

A Society may collect a service charge from any individual or group in consideration of any service, facility, technical know-how or training provided by it to him/ it in connection with micro-savings and micro-credit.

Fund of the Society [Sec. 24]

A Society shall have a separate Fund, which shall comprise the following amounts:

(a) Grants or loans received from Government of Nepal, Provincial Government or Bank or local or foreign organizations or associations,
(b) Amounts received through the collection of micro savings,
(c) Amounts received from commercial banks or financial institutions,
(d) A prescribed amount from the fees collected from the members of the society,
(e) Services charges collected in consideration of the services provided by the Society,
(f) Interest, fees etc. received from micro-credit transactions,
(g) Amounts received from other sources,

All expenses to be incurred in the name of the Society shall be borne from the fund. However, amounts collected through micro savings or received for micro credit shall not be disbursed for other purposes.

Funds of the Society shall be deposited in an account opened in any commercial bank or financial institution and such (bank) account shall be operated in the prescribed manner. In case the society is not currently in a position to supply micro-credit, it may, with the approval of the Bank, make investments in term deposits for a period not exceeding six months.

Risk-Bearing Fund

A Society shall establish a separate risk-bearing fund, in addition to the fund mentioned in section 24, for the purpose of bearing any possible loss in the course of supplying micro-credit. The prescribed (percentage) of the total outstanding credit invested until the day of the expiry of each financial year must be credited to that fund,

The amounts credited to the fund mentioned above may be invested by the Society in the securities of Government of Nepal or the Bank or in the term deposits of commercial banks or financial institutions.

The amounts credited to the fund shall be used only for waiving micro-credit. In case it becomes necessary to waive any micro credit, the Society must obtain the approval of the Bank. Establishment and Operation of Risk Bearing Fund is provided in Rule 10 of the Rules as follows:

(1) For the purpose of bearing possible loss while giving small credit, establishment of risk bearing fund should be established for the credit exceeding the time period after doing classification in four class for the remaining net credit as exceeding and not exceeding the time period from the investment available upto last day of the fiscal year.

(2) While doing classification as per sub-rule (1) credit not exceeding the time period good credit, exceeding six month of time period poor credit, more than six month upto one year doubtful credit and exceeding more than one year bad credit.

(3) Credit provided on the basis of installment recovery of each installment should be classified on the basis of exceeding and not exceeding time period as per sub rule (2). But if any one installment of credit provided to any loan taker on installment recovery exceeds more than one year then whole credit on the name of loan taker should be classified as bad credit.

Accounts and Audit of Societies

A Society shall maintain separately the accounts and records of its functions as a financial intermediary. It shall prepare a balance sheet of each financial year and have it audited by a recognized auditor appointed by its general meeting within six months after the expiry of the concerned financial year.

The same individual or firm shall not be appointed as auditor for more than three consecutive terms. The remuneration of the auditor shall be as prescribed by the general meeting of the Society.

The Bank may, if it so wishes inspect or make arrangements for inspecting the accounts and records of a Society at anytime.

2. FUNCTIONS, DUTIES & POWERS OF THE BANK

Power to Conduct Inspection or Investigation

The Bank may inspect or investigate the office or the functions and activities of a Society, or make arrangements for doing so, according to need. It shall be the duty of the concerned Society and employees to supply the documents or particulars demanded by the inspector or investigator in the course of conducting inspection or investigation under.

Power to Issue Directives and Cancellation of License

Section 18 provides, in case it is found in the course of inspection or investigation that a Society has taken any of the following actions, the Bank may direct the Society to introduce reforms or

make any special arrangement in respect to any of its functions and activities by prescribing a time limit for that purpose:

(a) In case it has not taken any action which it is required to take under this Act.
(b) In case it has taken any action which adversely affects the depositors and borrowers.
(c) In case it is not found to have properly maintained its ledgers, accounts or documents.
(d) In case it has not complied with any condition prescribed or directive issued by the Bank.
(e) In case it has misappropriated its funds, or used in activities opposed to the objectives of this act the funds received for the purpose.
(f) In case it has not supplied particulars, data or documents demanded under this Act.

The Bank may issue directives from time to time to a Society in respect to functions which it has to perform under this Act or the rules framed hereunder. It shall be the duty of the concerned Society to comply with such directives.

In case any society violates the directives issued by the Bank, it may issue a warning to it to correct its mistakes. In case any Society violates such directives for three times, or takes any of the following actions, the bank may suspend or cancel its license.

(a) In case the Society stops working as a financial intermediary,
(b) In case the Society misappropriates its funds, or does not use such funds for purposes for which they have been received,
(c) In case the Society does not comply with the directives issued by the Bank to introduce reforms or make any special arrangement in respect to any of its functions and activities by prescribing a time limit for that purpose,
(d) In case the Society fails to renew itself under the Associations Registration Act, 1977 and Section 7 of this Act.

The Bank may, if it so deems necessary before issuing an order of cancellation of license as above, have necessary inquiries or investigations conducted in that connection. Before canceling a license, the Bank shall provide the concerned Society with an opportunity to submit its explanations.

Power to Impose a Ban (on a Society) to work as a Financial Intermediary

In case it is not deemed appropriate to allow any society to continue working as a Financial Intermediary on the ground that it has taken any of the actions mentioned in Section 18, the Bank may provide it with an opportunity to introduce necessary reforms and impose a ban on it to work as a financial intermediary for a specified period of time.

Permission to Relinquish Functions of a Financial Intermediary

In case any Society applies to the Bank for permission to relinquish its functions of a financial intermediary, and in case the Society is found to have met in full all its liabilities, the Bank may grant it permission to relinquish its functions of a financial intermediary.

However, in case any Society has not been able to meet its liabilities in full, the Bank shall impose a ban on it to carry out functions of a financial intermediary and write to Government of

Nepal to have the liabilities of the Society met from its assets under the Associations Registration Act, 1977.

Realization From Personal Assets of Office Bearers

In case any office bearer of a Society performs or instigates the performance of the functions of a financial intermediary or misappropriates the funds of the Society with selfish or malafide movites in a manner opposed to the objectives of the Act, the Bank shall realize or make arrangements for realizing the funds so misappropriated from his personal assets or from any movable and immovable property within Nepal which is uner his name and ownership.

3. MISCELLANEOUS

Offenses and Penalties

In case any person works as a financial intermediary without obtaining a license under this act, he shall be punished with a fine not exceeding Rs. 20,000/- or with imprisonment for a term not exceeding six months, or with both. In case any Society does so, the office-bearer discharging the functions of that Society shall be subjected to such punishment.

In case any Society does not comply with this Act or the rules framed here under, or with any order directive issued by the Bank, or fails to Supply or submit particulars or documents demanded from it under this Act, or submits false information intentionally, and in case any loss or damage results therefrom, the amount involved in the loss or damage shall be recovered from the concerned employee, who shall also be punished with a fine not exceeding Rs. 10,000/- or with imprisonment for a term not exceeding six months, or with both.

In case any employee of a Society misappropriates its cash or supplies, or uses them for his personal purposes, the amount involved shall be realized from him, in addition to punishing him with a fine equal to that amount, or with imprisonment for a term not exceeding five years, or with both.

In case any employee of a Society cheats or illegally harasses or causes any hardship to any borrower, the Bank or the concerned party may initiate legal action against him according to current law.

Exemption from Registration Fee, Revenue Stamp Fee and Income Tax

No registration fee or revenue stamp shall be charged on the registration of any property in the name of a Society which it has obtained from a borrower as a collateral, or on the sale or purchase of any immovable property by a Society.

Government of Nepal may, by notification in the Nepal Gazette, grant full or partial income tax exemption on the income earned by a Society.

Right to Amalgamate or be Amalgamated

Notwithstanding anything contained in the Associations Registration Act 1977, in case two-thirds of total number of members present at a general meeting of a Society which is performing the functions of a financial intermediary under this Act approve a resolution to amalgamate any

other Society with the Society or be amalgamated to another society, the resolution shall be deemed to have been approved by the general meeting. Provided that, no proposal may be passed in a manner to merge or be merged to any institution that has not carried out the act of financial intermediation.

The resolution approved as above shall be submitted to the office which had registered the Society which is to be amalgamated and the Bank, and shall come into force only after receiving separate approval from both the office and the Bank. On receipt of such approval, the legal existence of the concerned society shall be deemed to have been ipso facto terminated.

The assets of the Society that is amalgamated as above shall devolve on the Society with which it has been amalgamated, and the latter must bear the liabilities of the former.

Preliminary Annual Reports

A Society shall submit to the Bank a preliminary annual report of its functions in the capacity of a financial intermediary along with a statement of its profit and loss within three months after the expiry of each financial year.

Consultation With Bank

It shall be mandatory to consult the Bank before dissolving a Society under the Associations Registration Act, 1977.

Applicability of Prevailing Law

Notwithstanding anything contained in prevailing law, action in respect to matters provided for in this Act or the rules framed here under shall be taken accordingly, and in respect to other matters, action shall be taken according to prevailing law.

Power to Frame Rules and By-rules

The Bank may frame rules in order to implement the objectives of this Act. Such rules shall come into force only after being approved by Government of Nepal.

A Society may frame bye-laws according to need in order to manage its functions, subject to this act or the rules framed here under. Such bye-laws shall come into force only after being approved by the Bank.

CHAPTER- 19

FOREIGN EXCHANGE (REGULATION) ACT, 2019

1. INTRODUCTION

Foreign exchange means a foreign currency, deposits, credits and balances of all types which are paid or received in a foreign currency, foreign securities and cheques, drafts, travelers cheques, electronic fund transfers, credit cards, letters of credit, bills of exchange and promissory notes which are in international circulation and are or can be paid in a foreign currency. This term also includes any other such monetary instruments as may be prescribed by the Bank by publishing and broadcasting a public notice.

Foreign Exchange (Regulation) Act, 2019 was was promulgated on 15th Ashadh 2019. The Act is promulgated with the objectives to regulate the foreign exchange related transaction in order to maintain the economic interests of the general public. It shall extend throughout Nepal and also apply to all citizens of Nepal who reside outside of Nepal, and all firms, companies, bodies and branches and agencies of such firms, companies or bodies which have been registered in Nepal and operating in any place outside of Nepal.

In this Act, following terminologies are defined as follows

(a) Foreign exchange transaction: means the purchase, sale, lending and borrowing the foreign exchange or receiving or giving of the foreign exchange in any other manner, and this term also includes the act of giving permission by the Bank to convert the foreign exchange.

(b) Securities: means shares, stocks, bonds, debentures, debenture stocks issued by any body corporate or unitary saving scheme certificate or collective saving scheme certificate or transferable deposit certificate issued by any body corporate in accordance with the prevailing law, and this term also includes such other securities or receipts relating to the deposit of securities and rights and powers relating to securities as may be specified by the Government of Nepal by a Notification in the Nepal Gazette.

(c) Foreign Investment: means the following investments made by a foreign investor in any firm, company or corporate body:
(i) Investments in shares,
(ii) Investment in deposits,
(iii) Reinvestment of income received in respect of the above (i) & (ii),
(iv) Investment in the form of loan or loan facilities.

(d) Technology Transfer: means the transfer of technology by means of an agreement between any firm, company or corporate body and the foreign investor in respect of the following matters:
(i) Use of any right, specialty, formula, process, patent or technical know-how of any technology of foreign origin,
(ii) Use of trade mark of foreign ownership,
(iii) Making available foreign technical consultant, management and market services.

(e) Foreign Investor: means any foreign individual, firm, company or corporate body who makes foreign investment or technology transfer and shall include foreign government or International bodies also.

(f) Gold: means and includes gold in the form of coins whether they are in circulation (legal tender) in legal manner or not, gold ingots and plates whether purified or not and the goods and jewelry made wholly or mainly from gold.

(g) Silver: means and includes silver in the form of coins whether in circulation as legal tender in a legal manner or not, silver in gots and plates whether purified or not, and the goods and jewelry made wholly or mainly from silver.

(h) Bank: means Nepal Rastra Bank.

(i) Owner in respect of any Security: means the person who has got the right to sell or transfer the title to the same or person who holds the securities in his own name or in some other person's name or a person receiving dividend or interest of such securities held in his name or in any other person's name and any person who has any right in respect of such securities.

If such securities are kept in a trust or the dividend or interest from such securities are kept in a trust fund, will include the person who has got the right to control the trust moneys, the person who or by taking or not taking consent from any other person has the right to operate or cancel or amend the trust or any of its terms.

(j) Person Resident in Nepal: Nepali citizens other the Nepali Citizens who reside outside Nepal beyond the period notified by the bank by general notification owing to employment, trade or any other business or work.

A non-Nepali citizen who stays in Nepal for a period more than that notified by the Bank by general notification on account of employment, trade or doing any other business or work.

(k) Person Resident outside Nepal: All other person than the person resident in Nepal.

Requirement of License for Carrying on Foreign Exchange Business

Any person, firm, company or corporate body desiring to do foreign exchange business should obtain license from the Bank. Such person shall submit an application to the Bank along with the prescribed particulars. On receipt of such application, the Bank shall make necessary inquiry into the matter and if it considers appropriate issue the license to the concerned person, firm, company or body. While giving such permission, the Bank may specify the kind of foreign exchange that can be transacted, limit and the period allowed to do business and other necessary conditions.

In order to regulate and manage the foreign exchange business, the Bank can issue necessary orders or directions from time to time to the license holders when duty is to comply with such orders and directions. For receiving the license, annual fee and security shall be provided to the Bank. If any license holder does not pay the annual fee or security, the Bank can cancel or suspend his license.

If any person, firm or company or body requests for a one-time license to do foreign exchange business, the Bank can issue one time license to such person subject to the provision of this section.

Section 3A provides, the Bank may take following action against any license holder if he does not comply with the orders and direction given under the Act:

(i) Warning,
(ii) Prohibit any or total business of foreign exchange,
(iii) Forfeit the cash security lying with the Bank or collect from the guarantee,
(iv) Cancel or suspend the license.

While taking action as above, the Bank shall have to give a suitable opportunity of hearing. In connection with foreign exchange business, other condition will be as notified by the Bank from time to time by public notice.

Procedure for Doing Foreign Exchange Business

No person shall do business of foreign exchange with others except with the license holder without taking permission from theBank. The license holder or any other person shall not do foreign exchange business by giving Nepali Rupees against foreign currency or giving foreign exchange against Nepali Rupees at the exchange rates different from that notified by the Bank.

If any person has obtained foreign exchange for any particulars purpose or on certain conditions, then that person shall not use it for any other purpose or in violation of the conditions. If the foreign exchange so obtained could not be utilised for the specified purpose or the conditions could not be fulfilled, the person who received the foreign exchange should return the same to the Bank or authorised foreign exchange dealer within 30 days from the date he come to know that the foreign exchange could not be utilised or the conditions could not be fulfilled.

If any person who obtains foreign exchange for the purpose of importing any goods into Nepal, does not import the goods within a reasonable time or he does not import goods equal to the value of foreign exchange obtained by him, he shall be deemed not able to utilise the foreign exchange received for the purpose for which it is received or he has not been able to fulfill the conditions for the use of such foreign exchange.

Foreign Exchange Obtained by Citizen of Nepal

Utilisation of foreign exchange received by a Nepali Citizen shall be according to the conditions prescribed by the Bank by means of a public notice. Any foreign exchange or any investment made by Nepali Citizen while residing abroad, can be kept in the foreign country if so desired except in the circumstances mentioned in section 6.

Section 6 provides that under the circumstances where there is a shortage of foreign exchange due to economic and monetary crisis in the country, Government of Nepal by publishing a notice in the Nepal gazette can order the Nepali Citizen holding foreign currency in his/her ownership to dispose off his/her foreign exchange as follows:

(a) To offer for sale at the exchange rate fixed by the Bank to the Bank or the person authorised by the Bank for the purpose to the account of Government of Nepal by the person holding the foreign exchange mentioned in the notice.

(b) To transfer the right a person has to transfer the right to receive the foreign exchange mentioned in the notice to another person, to the Government of Nepal by taking the value at the exchange rate prescribed by the Bank.

However, Government of Nepal may by the same notice or by issuing another order, may make the order not applicable to any particular person or class of persons.

Payment for Sale of Goods or Provision of Services to Foreigner [Sec. 4B]

Any person, firm or company or body resident in Nepal while receiving payment for goods sold or service rendered to any foreign individual, firm or company or body should receive the value in foreign exchange only unless the Bank has, by public notice, made other arrangements for the same.

Restriction on Export and Import of Certain Coins and Bullion

Government of Nepalmay pass an order by publishing a notice in the Nepal Gazette prohibiting the bringing in or taking out any particulars type of Nepali currency or foreign currency from or to all areas or any particulars areas of Nepal by any person, firm or company or body without obtaining the permission from the Bank. While passing such order the Government of Nepal may also notify that such prohibition does not apply to any particular type of Nepali currency and foreign currency or in relation to any particular individual, firm or company or body.

No person, firm or company or body shall take out or sent any foreign exchange outside Nepal except the foreign currency obtained from an approved foreign exchange dealer or Nepali currency without taking permission from the Bank.

However, Government of Nepal by notification in the Nepal gazette may notify that such restriction shall not apply in relation to any foreign exchange.

Duties of persons who could receive foreign exchange

Any person who has the right to receive foreign exchange or to receive payment in Nepali currency from outside Nepal, shall not, do anything, without the permission of the Bank, to delay the receipt or to avoid the receipt of the whole or any part of such foreign currency or Nepali currency.

If any person violates the above provision, the Bank may direct him, as necessary, to receive the foreign currency or to arrange for the payment to be received in Nepali currency.

Responsibility of an Importer [Sec. 8]

Any person, firm or company or body importing goods by opening Letter of Credit or by any other means into Nepal payable in foreign currency shall get the goods imported within the prescribed time and submit the documents prescribed by the Bank to the Bank.

The nature and process of obtaining foreign exchange for payment of imports shall be as prescribed by publishing a public notice.

Unless Bank's permission is obtained, importer should import the goods mentioned in the Letter of Credit up to the value and quantity mentioned in the Letter of Credit. Where amendment has been made in the Letter of Credit, then the amended quantity and value of goods should be imported.

Wherever any person opens a Letter of Credit in a commercial bank, another person, firm or company or body gives guarantee or directly or indirectly connected with such transaction for fraud or misuse of the foreign exchange committed notwithstanding any thing contained in any other law for the time being including such person, firm, company or body giving guarantee or directly or indirectly connected with the transaction shall be liable to punishment under this Act.

Notwithstanding anything contained in this Section, the procedure for import of and payment for know how and information technology, shall be as prescribed by public notice.

Importers should ensure proper billing and shall not do anything that is not or anything connected with improper billing.

Payment Against the Value of Goods Exported

Government of Neapl may by notification in the Nepal gazette, prohibit the export of goods listed in the said notification to any country outside Nepal except in accordance with the provision framed by it in consultation with the Bank.

Receipt of Payments for Exported goods [Sec. 9A]

(1) An exporter shall fill up the particulars mentioned in the declaration form prescribed by the Bank and declare before the Customs officer that he will bring payment in a foreign exchange approved by the Bank of the amount mentioned in such declaration form within the prescribed time limit.
(2) In circumstances in which the amount to be received as payment for exported goods is higher or lower than the amount mentioned in the declaration form before receiving payment for the exported goods, the exporter shall submit an application to the Bank along with evidence thereof, and in case the matter is proved, the Bank may grant approval for receiving such higher or lower amount.
(3) In case the exporter failed to obtain payments for the exported goods within the time limit prescribed under Sub section (1), he shall be deemed to have violated this act.
(4) Notwithstanding anything contained in Sub-section (3), in case the exporter submits an application to the Bank clearly mentioning legitimate reasons for his failure to obtain payments for the exported goods within the time limit prescribed under Sub-section (1), and in case the Bank is satisfied with such reason, it may order the exporter as follows after prescribing another time limit:
    (a) If the goods have already been sold, to bring payments therefore,
    (b) If the goods have not yet been sold, to sell them and bring the payments, or to bring the goods back to Nepal.

However, in case any exporter submits an application to the Bank citing any appropriate reason for his failure to bring in payments for goods exported by him due to circumstances beyond his control, the Bank shall conduct necessary investigations and permit him to bring the goods back or exempt him from bringing in payments either fully or partially.

(5) In case the Bank wishes to authenticate that the amount mentioned in the declaration form will be paid in the prescribed manner within the prescribed time limit, it may ask the exporter to submit the agreement concluded by the exporter with the foreign buyer in that connection, as well as other evidence.
(6) For the purpose of ensuring the full receipt of payments for exported goods, the Bank may issue orders in regard to all or any specific type of goods, or all or any specific exporter, making it obligatory to act as follows:
    (a) Except in circumstances when Government of Nepal has prescribed otherwise, to receive payments for exported goods either through Letters of Credit or through other means prescribed by the Bank.
    (b) For the purpose of certifying that the price mentioned in the declaration form under Sub-section (1) is the actual export price, to submit such declaration form to the authority or institution prescribed by the Bank.
(7) Notwithstanding anything contained elsewhere in this Section, provisions concerning the export of know how and information oriented technologies and the procedure of receiving payments therefore shall be as prescribed by the Bank through the publication and broadcast of public notifications.

Action Not be Taken by an Exporter [Sec. 9B]

An exporter must not take any of the following actions:

(a) To receive payment for goods exported in any manner other than the prescribed manner.
(b) To make arrangements or obtaining payments for exported goods at a time later than the prescribed time limit.
(c) To do anything for not receiving full payment for the exported goods.
(d) Do anything that does not result in correct invoicing or any other thing related to such actions.

Restrictions on making or obtaining payments [Sec. 9C]

No person living in Nepal shall directly or otherwise take any of the following actions except according to provisions prescribed by the Bank:

(a) To make payments of any kind to any person living outside Nepal through any means;
(b) To draw, accept, or negotiate any bills of exchange or promissory notes, or approve loans, in such a way as to create in favor of or transfer to any person living outside Nepal the authority to receive payments.
(c) To make payments of any kind to any person on the order or on behalf of any person living outside Nepal.

Control on the Export and Transfer of Dhitopatra/Securities [Sec. 10]

No person shall take any of the following actions except according to provisions prescribed by the Bank:

(a) Export any security to any place outside Nepal,
(b) Transfer any security to any person residing outside Nepal,
(c) Give away any security to any person residing outside Nepal for the purpose of earning, using, or controlling it.

Ban on Investment [Sec. 10A]

Every investment to be made by any person in a foreign country or by any foreign investor in Nepal according to current law shall be made in the manner prescribed by the Bank through the publication and broadcast of public notifications. However, this Section shall not be deemed to be prejudicial to any investment made in a foreign country by any Nepali national residing in Nepal from his earnings while residing in the foreign country.

Provisions concerning Lending and Borrowing Foreign Exchange [Sec. 10B]

No one shall lend or borrow foreign exchange except according to the provisions of prevailing law and the provisions prescribed by the Bank through the publication and broadcast of public notifications.

Provisions concerning Repatriation, Investment and Tranfer of Title to Foreign Exchange [Sec. 10C]

(1) Every foreign investor who has obtained permission under prevailing law to make investments in Dhitopatra (Securities)) may repatriate the following amounts in foreign exchange outside Nepal according to the procedure prescribed by the Bank through the publication and broadcast of public notifications:
    (a) Investments made in Dhitopatra(Securities)) and profits or dividends received in consideration there of,
    (b) Investments made in the form of loans or credit facilities, and interest there on.
(2) In case any Nepali national residing outside Nepal is granted permission to make foreign exchange investments in Nepal, he shall be provided with the facility mentioned in Sub-Section (1).
(3) Among the securities mentioned in clause (a) of Sub-Section (1), the amount calculated on the basis of the price at which the concerned securities have been transacted at the securities exchange, in the case of listed securities, and the amount calculated on the basis of the assets of the concerned institution determined according to the procedure prescribed by the Bank through the publication and broadcast of public notifications, in the case of unlisted securities, may be repatriated in foreign exchange.
(4) Title to the securities acquired by any foreign individual, firm, company or institution may be transferred to any other foreign individual, firm, company or institution by fulfilling the formalities laid down in prevailing law in case taxes or fees payable according to prevailing law are paid in a foreign currency.
(5) Amounts received as technical fees, royalties, etc. mentioned in the technology transfer agreement signed by a foreign investor according to prevailing law may be repatriated.

(6) Action in respect to repatriation in consideration of air tickets sold and cargo services provided in Nepal by a licensed foreign airline operating in Nepal, or its agent, or any Nepali individual, firm, company or institution authorized to perform such functions, shall be taken in the manner prescribed by the Bank through the publications and broadcast of public notifications.
(7) Notwithstanding anything contained elsewhere in this Section, no individual, firm, company or institution making investment in Nepali currency but not earning any foreign currency may pay or accept payments in a foreign currency under this Section.

Power to Demand Particulars [Sec. 11]

In case Government of Nepal;, or the Bank feels that it is necessary or desirable to obtain or check any particulars, accounts, or declarations for the purpose of carrying out the objectives of this act, and that any particulars person possesses such particulars, accounts, or declarations, or that there is a possibility of a particular person obtaining and submitting the same, Government of Nepal or the Bank may direct any such person to submit such particulars, accounts, or declarations or do so after obtaining them.

Designation of Investigating Authority

Government of Nepal may designate an Investigating Officer in order to inquire and investigate into offenses under this act.

Power to Search Suspected Person, Stop & Search Vehicle

In case there exist sufficient reasons and grounds to suspect that any person possesses any foreign exchange in contravention of this act, the body of such person may be searched through an employee of at least Gazetted Class II rank on the orders of the Investigating Officer. However, a woman may be searched by a woman only. In case any foreign exchange or any document relating there to in contravention of this act is found while searching a suspected person, such foreign exchange or document may be seized.

Searches under this act must be conducted in the presence of at least two local persons. A statement of the foreign exchange or relevant documents found in the course of the search shall be prepared, and witnesses shall also be made to affix their signatures there on.

In case there exist sufficient reasons and grounds to suspect that any vehicle has been or is going to be used for actions in contravention of this act, or that any foreign currency has been hidden in contravention of this act, such vehicle may be stopped at any time or place on the orders of the Investigation Authority. Any part of the vehicle stopped as such or any goods contained in such vehicle, may be searched or investigated. In case any foreign exchange or any relevant document which is in contravention of this act is found in the course of the search, it may be seized.

Power to Search Houses or Places of Business [Sec. 11D]

(1) In case there exist sufficient reasons and grounds to believe that any foreign exchange is being kept or hidden inside any house or place of business in contravention of this act, the Investigation Authority shall prepare a statement thereof and issue an order for searching such house or place of business.

(2) The searches to be carried out in accordance with the order issued under Sub-Section (1) shall be carried out by an employee of at least Non-Gazetted Second Class employee.
(3) The employee deputed to carry out a search on the orders of the Investigating Officer must give a notice to the person residing at the time in the house or place of business which is to be searched clearly mentioning the reasons why the search is to be conducted. In case the concerned person does not acknowledge such notice, a copy thereof shall be affixed at a conspicuous place of the house or place of business which is to be searched. Once the notice is so affixed, the concerned person shall be considered to have received it.
(4) After the concerned person is given a notice according to Sub-Section (3), the employee deputed to carry out the search shall be allowed to search the house or place of business.
(5) In case the concerned person opposes or creates obstruction in the search, the employee deputed to conduct the search shall give a notice and opportunity to persons residing in the house or places of business to leave. In case such persons do not do so even when they are given an opportunity, the search may be conducted at any time by using necessary force and breaking open outer or inner doors or windows, or by opening or breaking locks.
(6) In case any foreign exchange or relevant document which is in contravention of this act is found in the course of the search, such foreign exchange or document may be seized.
(7) Searches under this act must be conducted in the presence of a member of the Village Council or the Municipality, or at least two local prominent persons. A statement of the foreign exchange or relevant document which is in contravention of this act and is found in the course of the search shall be prepared, and the witnesses present during the search shall also be made to affix their signatures there on.

Arrest & Detention

If there is adequate reason and ground to doubt that any person has done an act or is going to do any act in contravention of this Act, such a person may be arrested at any place after issuance of arrest warrant by the concerned court after submission of application to the court by the investigating officer. However, if such person is not arrested there is possibility of run away or destroying evidence, such person may be immediately arrested by issuing arrest warrant. The arrested person shall be presented before the case trying authority within 24 hours excluding the time required for journey.

The person arrested under this act may be kept in detention for not more than seven days at a time and a total of 30 days with the approval of the adjudicating authority.

Secrecy Not to be Violated [Section 11G]

The Investigating Officer or his subordinate employees must not violate the secrecy of any information received, or of any document submitted to them in their official capacity while taking action under this act in any circumstance except when so compelled by current law.

However, in case the adjudicating authority thinks that such information or document is necessary, or is likely to constitute evidence in other legal suits, and in case the secrecy of such information or document is disclosed before legally authorized person on the orders of the adjudicating authority, such disclosure shall not be considered to have violated the secrecy.

Submission of Reports [Section 11J]
The Investigating Officer shall submit before Government of Nepal every month a report of the functions and operations undertaken by him under this act.

Power of the Bank to issue Directions, Frame Regulations or Issue Orders or Notifications
The Bank may from time to time issue such directions or frame such regulations or issue such orders or notifications as may be necessary for the purpose of implementing the provisions of this act.

Restriction on settlement of Contracts Repugnant to the Objectives of the Act

No person shall execute contracts of any kind in a manner conflicting with any provisions made under this act or the rules and regulations framed or directions or orders or notifications issued here under.

In case any kind of contract is found to have been concluded, or documents signed, in contravention of this Act, such contracts or documents may be invalidated if the court disposing of cases under this act so orders.

Inspection [Sec. 14]

(1) Governmentof Nepal or the Bank may inspect or direct the inspection of the accounts, records and other documents of any license-holder at anytime.
(2) It shall be the duty of every license-holder to submit all records, accounts, and documents pertaining to foreign exchange transactions, as well as particulars or information related thereto, which are under his charge or control, as asked for by the employee deputed to conduct inspection under Sub-Section (1), within the period prescribed by such employee. In case the license-holder is a firm, company or institution, such record, accounts, documents, particulars or information shall be submitted or supplied by its Director or concerned office-bearer or any partner or office-bearer connected with the concerned functions.
(3) The employee deputed to conduct inspection under Sub-Section (1) may interrogate orally or in writing any license-holder or his agent, or in case the license holder is a firm, company or corporate body, its Director or concerned office bearer.
(4) In case any individual or the Director or office-bearer of any firm, company, or institution, does not submit or supply any records, accounts or documents or any particulars or information required under Sub-section (2), or does not furnish replies to questions asked by the employee deputed to conduct inspection, he shall be deemed to have violated this Act.
(5) In case the employee deputed to conduct inspection under Sub-Section (1) finds in the course of inspection any foreign exchange or any documents, accounts, records or particulars related thereto, which was being kept in a manner contrary to this Act, he may take them into his custody or lock them up in a safe of room, and seal it.
(6) While taking into custody or sealing foreign exchange or documents under Sub- Section (5), the employee deputed to conduct inspection must prepare a list of things so taken into custody in the presence of the concerned license-holder or at least two other persons, and have the same signed by witnesses as well.

Approval of the Bank to be obtained to Open Account

Any Nepali national living in Nepal, or any company, corporate body or firm registered in Nepal, must obtain the approval of the Bank while opening accounts in banks located in foreign countries.

While granting approval to open accounts as such, the Bank may demand necessary particulars and also prescribed conditions. Such accounts shall be operated and used in the manner prescribed by the Bank through the publication and broadcast of public notifications.

Action in respect to the opening, operation and use of foreign currency accounts in Nepal by a Nepali national residing in Nepal, or by any firm, company or institution registered in Nepal, shall be taken in the manner prescribed by the Bank through the publication and broadcast of public notifications.

Punishment [Section 17]

(1) In case any person takes any action in contravention of any provision of this Act or of the rules framed under this Act, or orders, directives, circulars, or notices issued there under, or any procedure prescribed by the Bank, the foreign exchange connected with the offense shall be confiscated and such person shall be punished with a fine equal to the amount involved in the offense, and an additional fine not exceeding three times thereof. However, in respect to offenses committed in circumstances in which the foreign exchange connected with the offense cannot be confiscated, the amount of such foreign exchange shall be determined and the concerned person shall be punished with a fine of a equal amount and an additional fine not exceeding three times there of.

(2) In case the amount involved in the offense is not or cannot be determined under Sub-Section (1), a fine not exceeding Rs. 200,000 shall be imposed in the light of the degree of the offense.

(3) In case any employee deputed to perform functions or conduct inspection and investigations under this Act takes any action or violates secrecy in contravention of this Act by working with mollified motives, he shall be punished with a fine not exceeding Rs. 100,000, depending on the degree of the offense.

(4) In case any offense punishable under this Act is committed by any firm, company or institution, the Director, office-bearer, employee or agent of the concerned firm, company or institution responsible for the action connected with the offense at the time of its commission shall be liable to punishment. However, in case such Director, office-bearer, employee or agent submits evidence to the effect that he was in no position to know about the commission of such offense, or that he had made all possible efforts to prevent such offense, he shall not be required to bear liability for the penalty under this Sub-Section.

(5) Any importer who has made imports without fulfilling the formalities to be fulfilled or the procedure to be completed in respect to imports under Section 8, or by over-invoicing, or failed to import the concerned goods within the prescribed time-limit or to import the goods to be imported, shall be punished with a fine equal to the amount involved in the import after determining such amount, and an additional fine not exceeding three times there of.

(6) Any exporter who commits an offense under Section 9A, 9B & 9C shall be punished with a fine equal to the amount involved in the goods exported and an additional fine not exceeding two times there of.
(7) Any person who abets in or helps to commit any offense mentioned in Sub- Sections (5) and (6) shall be punished with half of the punishment mentioned in those Sub-Sections.
(8) Any person who fails to pay fines imposed under this Section may be punished with imprisonment for a term not exceeding four years, depending on the amount of the fine.
(9) Notwithstanding anything contained elsewhere in this Section, in case the amount involved in an offense connected with foreign exchange is Rs.10 million or more, the concerned person shall also be punished with imprisonment for a term not exceeding three years, in additional to other punishment to be inflicted on him.
(10) Action may be initiated against any person who has been arrested by the Investigating Officer in the course of investigations, or who has been accused by the concerned court in connection with a case, by keeping him on bail in offenses involving not more than Rs.100,000, and by collecting a deposit according to the amount involved in the offense or by collecting a deposit fixed according to such amount and requiring a deposit fixed according to such amount and requiring him to appear on fixed dates, in offenses involving more than Rs.100,000.
(11) In case the chief or any member or a constitutional body or any person occupying a post of political appointment takes any action which is deemed to be an offense under this Act, he shall be punished with double the punishment to be inflicted on any other person committing the sameoffense. However, in the case of punishment with imprisonment, the term of imprisonment shall not be increased by more than two years.
(12) Action against every person who fails to pay the deposit amount under Sub- Section (10) shall be taken by keeping him indetention.

Adjudicating Authority, Appeal & Filing of Cases

The prescribed court shall have the power to hear and dispose of cases relating to offenses under this act. An appeal may be filed in the High Court against the verdict of the prescribed court.

Cases relating to offenses under this act, shall be filed by the Investigating Officer in the name of Government of Nepal. The Investigating Officer shall obtain the opinion of the government attorney while filing the cases

Reward for Furnishing Information

In case any person reports to Government of Nepal, or to an officer authorized by Government of Nepal, that any person has committed any offense concerning foreign exchange in contravention of this act, or the rules, bye-rules, orders, notifications, directives or permission or licenses issued hereunder, and in case such reports lead to the confiscation of foreign exchange and prove that the offense has been committed, he shall be given as reward 20 percent of the value of the confiscated after it is converted into Nepali currency. The reward to be granted shall be paid from the value of the confiscated foreign exchange after it is converted into Nepali currency once the case is disposed of.

Claims or Complaints not to be Entertained

No case of complaint shall be filed, or legal action taken, in any court against any person for any action taken or intended to be taken by him under this act or any rule, sub-rule, order, or notification, or instruction issued hereunder with bonafide motives. No claim shall be entertained for any loss or damage sustained by any person by reason of the failure to supply foreign exchange on the part of Government of Nepal or the Bank or any license-holder, except when such loss or damage is caused deliberately or carelessly.

Power to Frame Rules

Government of Nepal may frame rules for the purpose of implementing the objectives of this act in consultation with the Bank.

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