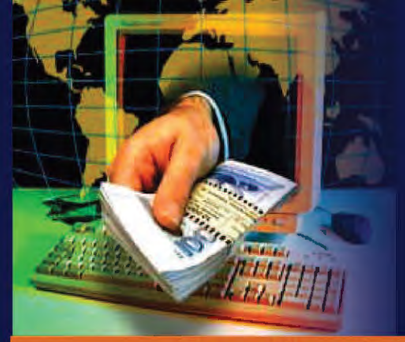

Institute of **Open** and **Distance Education**

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CONTENTS

UNIT I

LESSON

1

COMPANY: AN INTRODUCTION

CONTENTS

1.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Elucidate the meaning of company as a form of business organisation
- Describe the characteristics of company

- Identify the various types of companies
- Distinguish between public and private company
- Discuss the Companies Act, 1956 based on Bhabha Committee Recommendations
- Recognise the evolution of the Companies Act, 2013

1.1 INTRODUCTION

The word Company denotes any entity formed under the Companies Act, 2013. The term company refers to the association of person working together. A company is a voluntary association of individuals formed to carry on business to earn profits or for non-profit purposes. These persons contribute towards the capital by buying its shares in which it is divided.

The term "company" was originally used for that group of person who took their meal together.

From here we can say that "company" means that group of persons who get associated for common lawful purpose.

A company is an association of individuals incorporated as a company possessing a common capital i.e., share capital contributed by the members comprising it for the purpose of employing it in some business to earn profit. The multinational companies like *Coca-Cola* and *General Motors* have their investors and customers spread throughout the world. The giant Indian Companies may include the names like Reliance, Talco Bajaj Auto, Infosys Technologies, Hindustan Lever Ltd., Ranbaxy Laboratories Ltd., and Larsen and Toubro, etc.

In this lesson, we shall study about company, its characteristics and the types of company. After reading this lesson you would be able to understand the concepts of various types of companies, their legal basis, special provisions and privileges for some classes of companies, distinction between different types of companies, etc.

1.2 DEFINITION OF COMPANY

Definition of Company under ***Companies Act, 2013:*** According to Section 2(20) of Companies Act, 2013 "company" means a company incorporated (formed and registered) under this Act or under any of the previous companies laws.

Section 3(1)(i) of the Companies Act, 1956 defines a company as "a company formed and registered under this Act or an existing company". Section 3(1)(ii) of the act states that "an existing company means a company formed and registered under any of the previous companies laws". This definition does not reveal the distinctive characteristics of a company.

Chief Justice Marshall of the USA defines, "A corporation is an artificial being, invisible, intangible, existing only in contemplation of the law. Being a mere creation of law, it possesses only the properties which the charter of its creation confers upon it, either expressly or as incidental to its very existence".

According to ***Prof Haney***, "Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares. The ownership of which is the condition of membership".

Another comprehensive and clear definition of a company is given by ***Lord Justice Lindley***, "A company is meant an association of many persons who contribute money or money's worth to a common stock and employ it in some trade or business, and who share the profit and loss (as the case may be) arising there from.

The common stock contributed is denoted in money and is the capital of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his share. Shares are always transferable although the right to transfer them is often more or less restricted".

From the above definitions, it can be concluded that a company is registered association which is an artificial legal person, having an independent legal, entity with a perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.

1.3 CHARACTERISTICS OF COMPANY

The main characteristics of a company are (refer figure 1.1):

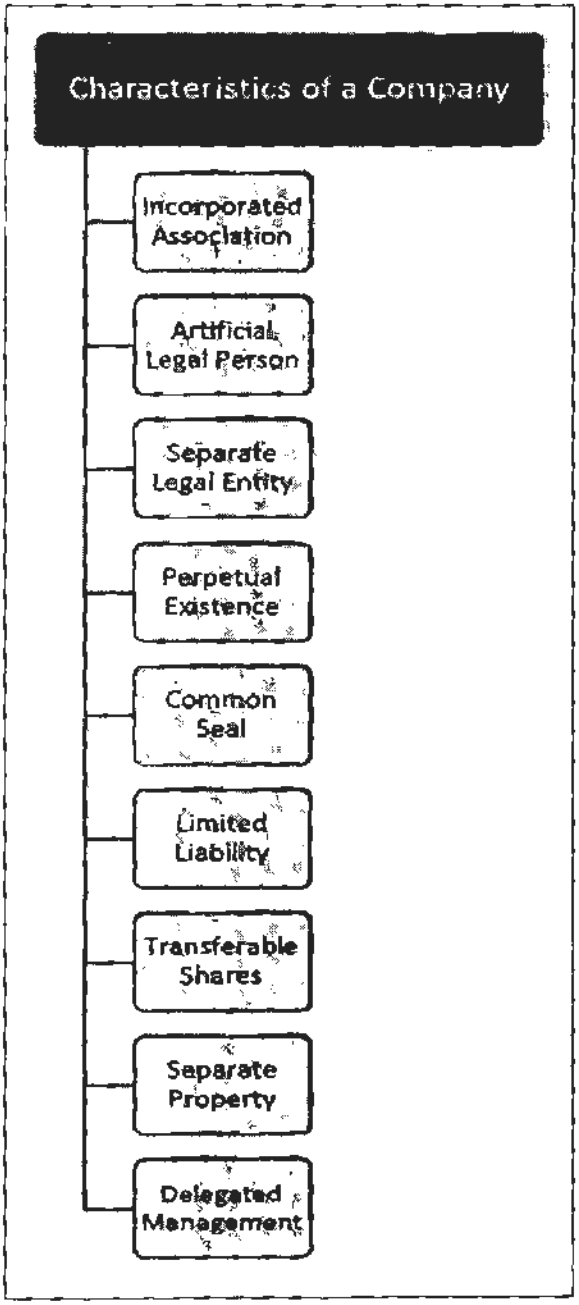


Figure 1.1: Characteristics of a Company

1. ***Incorporated Association:*** A company is created when it is registered under the Companies Act. It comes into being from the date mentioned in the certificate of incorporation.

   It may be noted in this connection that Section 11 provides that an association of more than ten persons carrying on business in banking or an association or more than twenty persons carrying on any other type of business must be registered under the Companies Act and is deemed to be an illegal association, if it is not so registered.

   For forming a public company atleast seven persons and for a private company atleast two persons are required. These persons will subscribe their names to the Memorandum of Association and also comply with other legal requirements of the Act in respect of registration to form and incorporate a company, with or without limited liability [Sec 12 (1)].

2. ***Artificial legal person:*** A company is an artificial person. Negatively speaking, it is not a natural person. It exists in the eyes of the law and cannot act on its own. It has to act through a board of directors elected by shareholders.

   It was rightly pointed out in Bates V Standard Land Co. that: "The boards of directors are the brains and the only brains of the company, which is the body and the company can and does act only through them".

   But for many purposes, a company is a legal person like a natural person. It has the right to acquire and dispose of the property, to enter into contract with third parties in its own name and can sue and be sued in its own name.

   However, it is not a citizen as it cannot enjoy the rights under the Constitution of India or Citizenship Act. In State Trading Corporation of India v C.T.O. (1963 SCJ 705), it was held that neither the provisions of the Constitution nor the Citizenship Act apply to it.

   It should be noted that though a company does not possess fundamental rights, yet it is a person in the eyes of law. It can enter into contracts with its Directors, its members, and outsiders.

   Justice Hidayatullah once remarked that if all the members are citizens of India, the company does not become a citizen of India.

3. ***Separate Legal Entity:*** A company has a legal distinct entity and is independent of its members. The creditors of the company can recover their money only from the company and the property of the company. They cannot sue individual members.

   Similarly, the company is not in any way liable for the individual debts of its members. The property of the company is to be used for the benefit of the company and not for the personal benefit of the shareholders.

   On the same grounds, a member cannot claim any ownership rights in the assets of the company either individually or jointly during the existence of the company or in its winding up.

   At the same time the members of the company can enter into contracts with the company in the same manner as any other individual can. Separate legal entity of the company is also recognized by the Income Tax Act.

   Where a company is required to pay Income-tax on its profits and when these profits are distributed to shareholders in the form of dividend, the shareholders have to pay income-tax on their dividend of income. This proves that a company and its shareholders are two separate entities.

The principal of separate legal entity was explained and emphasized in the famous case of *Salomon v Salomon & Co. Ltd.*

The facts of the case are as follows:

Mr Saloman, the owner of a very prosperous shoe business, sold his business for the sum of $ 39,000 to Saloman and Co. Ltd. which consisted of Saloman himself, his wife, his daughter and his four sons.

The purchase consideration was paid by the company by allotment of & 20,000 shares and $ 10,000 debentures and the balance in cash to Mr. Saloman. The debentures carried a floating charge on the assets of the company.

One share of $ 1 each was subscribed by the remaining six members of his family. Saloman and his two sons became the directors of this company. Saloman was the managing Director.

After a short duration, the company went into liquidation. At that time the statement of affairs' was like this: Assets: $ 6000, liabilities. Saloman as debenture holder $ 10,000 and unsecured creditors $ 7,000. Thus, its assets were running short of its liabilities by $11,000.

The unsecured creditors claimed a priority over the debenture holder on the ground that company and Saloman were one and the same person. But the House of Lords held that the existence of a company is quite independent and distinct from its members and that the assets of the company must be utilized in payment of the debentures first in priority to unsecured creditors.

Saloman's case established beyond doubt that in law a registered company is an entity distinct from its members, even if the person holds all the shares in the company. There is no difference in principle between a company consisting of only two shareholders and a company consisting of two hundred members. In each case the company is a separate legal entity.

The principle established in Saloman's case has also been applied in the following:

Lee V. Lee's Airforming Ltd. (1961) A.C. 12 of the 3000 shares in Lee's Air Forming Ltd., Lee held 2999 shares.

He voted himself the managing Director and also became Chief Pilot of the company on a salary. He died in an aircrash while working for the company.

His wife was granted compensation for the husband in the course of employment. Court held that Lee was a separate person from the company he formed, and compensation was due to the widow.

Thus, the rule of corporate personality enabled Lee to be the master and servant at the same time. The principle of separate legal entity of a company has been, in fact recognized much earlier than in Saloman's case.

In Re Kondoi Tea Co. Ltd. (1886 ILR 13 Cal 43), (7) it was held by Calcutta High Court that a company was a separate person, a separate body altogether from its Shareholders.

In Re. Sheffield, etc. Society - 22 OBD 470), it has been held that a corporation is a legal person, just as much in individual but with no physical existence.

The characteristic of separate corporate personality of a company was also emphasized by Chief Justice Marshall of USA when he defined a company "as a person, artificial, invisible, intangible and existing only in the eyes of the law.

Being a mere creation of law, it possesses only those properties which the charter of its creation confers upon it either expressly or as accident to its very existence". [Trustees of Darmouth College v. Woodward (1819) 17 US 518)

4. ***Perpetual Existence:*** A company is a stable form of business organization. Its life does not depend upon the death, insolvency or retirement of any or all shareholder (s) or director (s).

   Law creates it and law alone can dissolve it. Members may come and go but the company can go on forever.

   "During the war all the member of one private company, while in general meeting, were killed by a bomb. But the company survived: not even a hydrogen bomb could have destroyed it".

   The company may be compared with a flowing river where the water keeps on changing continuously: still the identity of the river remains the same.

   Thus, a company has a perpetual existence, irrespective of changes in its membership.

5. ***Common Seal:*** As was pointed out earlier, a company being an artificial person has no body similar to natural person and as such it cannot sign documents for itself.

   It acts through natural person who are called its directors. But having a legal personality, it can be bound by only those documents which bear its signature.

   Therefore, the law has provided for the use of common seal, with the name of the company engraved on it, as a substitute for its signature. Any document bearing the common seal of the company will be legally binding on the company.

   A company may have its own regulations in its Articles of Association for the manner of affixing the common seal to a document.

   As per Regulation 84 of Table-A the seal of the company shall not be affixed to any instrument except by the authority of a resolution of the Board or a Committee of the Board authorized by it in that behalf, and except in the presence of atleast two directors and of the secretary or such other person as the Board may appoint for the purpose and those two directors and the secretary or other person aforesaid shall sign every instrument to which the seal of the company is so affixed in their presence.

6. ***Limited Liability:*** A company may be company limited by shares or a company limited by guarantee. In company limited hy shares, the liability of members is limited to the unpaid value of the shares.

   For example, if the face value of a share in a company is ₹10 and a member has already paid ₹7 per share, he can be called upon to pay not more than ₹3 per share during the lifetime of the company.

   In a company limited by guarantee the liability of members is limited to such amount as the member may undertake to contribute to the assets of the company in the event of its being wound up.

7. ***Transferable Shares:*** In a public company, the shares are freely transferable. The right to transfer shares is a statutory right and it cannot be taken away by a provision in the articles.

   However, the articles shall prescribe the manner in which such transfer of shares will be made and it may also contain *bona fide* and reasonable restrictions on the right of members to transfer their shares.

But absolute restrictions on the rights of members to transfer their shares shall be ultra vires.

However, in the case of a private company, the articles shall restrict the right of member to transfer their shares in companies with its statutory definition

In order to make the right to transfer shares more effective, the shareholder can apply to the Central Government in case of refusal by the company to register a transfer of shares.

8. ***Separate Property:*** As a company is a legal person distinct from its members, it is capable of owning, enjoying and disposing of property in its own name

   Although its capital and assets are contributed by its shareholders, they are not the private and joint owners of its property.

   The company is the real person in which all its property is vested and by which it is controlled, managed and disposed of.

9. ***Delegated Management:*** A joint stock company is an autonomous, self-governing and self-controlling organization.

   Since it has a large number of members, all of them cannot take part in the management of the affairs of the company.

   Actual control and management is, therefore, delegated by the shareholders to their elected representatives, known as directors. They look after the day-to-day working of the company.

   Moreover, since shareholders, by majority of votes, decide the general policy of the company, the management of the company is carried on democratic lines. Majority decision and centralized management compulsorily bring about unity of action.

1.4 TYPES OF COMPANY

The Companies Act, 2013 provides for the kinds of companies that can be promoted and registered under the Act. The three basic types of companies which may be registered under the Act are (refer figure 1.2):

(a) Private Companies;

(b) Public Companies; and

(c) One Person Company (to be formed as Private Limited).

Section 3.

1. Of the Companies Act 2013 states that a company may be formed for any lawful purpose by:

   (a) seven or more persons, where the company to be formed is to be a public company;

   (b) two or more persons, where the company to be formed is to be a private company; or

   (c) one person, where the company to be formed is to be one person company that is to say, a private company, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration.

2. A company formed under sub-section (1) may be either — (a) a company limited by shares; or (b) a company limited by guarantee; or (c) an unlimited company.

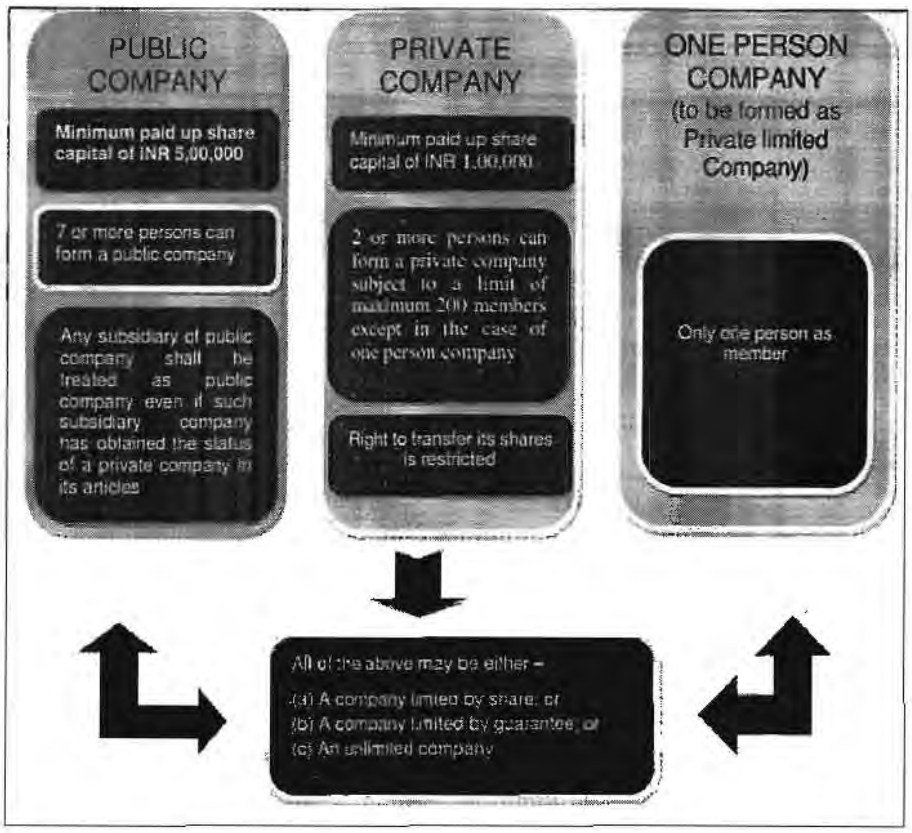


Figure 1.2: Types of Companies under the Companies Act, 2013

1.4.1 Classification of Companies

Let us study the classification of companies:

(i) ***Classification on the basis of Incorporation:*** There are three ways in which companies may be incorporated:

(a) *Statutory Companies:* These are constituted by a special Act of Parliament or State Legislature. The provisions of the Companies Act, 2013 do not apply to them. Examples of these types of companies are Reserve Bank of India, Life Insurance Corporation of India, etc.

(b) *Registered Companies:* The companies which are incorporated under the Companies Act, 2013 or under any previous company law, with Registrar of Companies fall under this category.

(ii) ***Classification on the basis of Liability:*** Under this category there are three types of companies:

(a) *Unlimited Liability Companies:* In this type of company, the members are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited. Such companies may or may not have share capital. They may be either a public company or a private company.

(b) *Companies Limited by Guarantee:* A company that has the liability of its members limited to such amount as the members may respectively undertake, by the memorandum, to contribute to the assets of the company in the event of

being wound-up, is known as a company limited by guarantee. The members of a guarantee company are, in effect, placed in the position of guarantors of the company's debts up to the agreed amount.

(c) *Companies Limited by Shares:* A company that has the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them is termed as a company limited by shares. For example, a shareholder who has paid ₹75 on a share of face value ₹100 can be called upon to pay the balance of ₹25 only. Companies limited by shares are by far the most common and may be either public or private.

(iii) ***Other Forms of Companies***

(a) Associations not for profit having license under Section 8 of the Companies Act, 2013 or under any previous company law;

(b) Government Companies

(c) Foreign Companies

(d) Holding and Subsidiary Companies

(e) Associate Companies/Joint Venture Companies

(f) Investment Companies

(g) Producer Companies

(h) Dormant Companies

1.4.2 Private Company

As per Section 2(68) of the Companies Act, 2013, "private company" means a company having a minimum paid-up share capital of one lakh rupees or such higher paid-up share capital as may be prescribed, and which by its articles:

(i) Restricts the right to transfer its shares;

(ii) Except in case of One Person Company, limits the number of its members to two hundred;

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this definition, be treated as a single member;

Provided further that the following persons shall not be included in the number of members:

(a) Persons who are in the employment of the company; and

(b) Persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, and

(iii) Prohibits any invitation to the public to subscribe for any securities of the company

It must be noted that it is only the number of members that is limited to two hundred. A private company may issue debentures to any number of persons, the only condition being that an invitation to the public to subscribe for debentures is prohibited.

The aforesaid definition of private limited company specifies the restrictions, limitations and prohibitions, which must be expressly provided in the articles of association of a private limited company.

As per proviso to Section 14 *(1)*, if a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, such company shall, as from the date of such alteration, cease to be a private company.

A private company can only accept deposit from its members in accordance with section 73 of the Companies Act, 2013. The words 'Private Limited' must be added at the end of its name by a private limited company.

As per section 3 *(1)*, a private company may be formed for any lawful purpose by two or more persons, by subscribing their names to a memorandum and complying with the requirements of this Act in respect of registration.

Section 149 *(1)* further lays down that a private company shall have a minimum of two directors. The only two members may also be the two directors of the private company.

Privileges and Exemptions of Private Company

The Companies Act, 2013 confers certain privileges on private companies which are not subsidiaries of public companies. Such companies are also exempted from complying with quite a few provisions of the Act.

The basic rationale behind this is that since private limited companies are restrained from inviting capital and deposits from the public, not much public interest is involved in their affairs as compared to public limited companies. Private limited companies lose the privileges and exemptions the moment they cease to be private companies.

Privileges of a Private Limited Company

Some privileges and exemptions enjoyed by a private company or its advantages over a public company include the following given in Table 1.1:

Table 1.1: Privileges of a Private Limited Company

Section	Nature of exemptions/privileges
67(2)	Financial assistance can be given to its employees for purchase of or subscribing to its own shares or shares in its holding company.
121(1)	Need not prepare a report on the Annual General Meeting.
134(3)(p)	Need not prepare a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors.
149(1)	Private company need not have more than two directors.
149(4)	Need not appoint independent directors on its Board.
152(6)	A proportion of directors need not retire every year.
164(3)	Additional grounds for disqualification for appointment as a director may be specified by the company in its articles.
165(1)	Restrictive provisions regarding total number of directorships which a person may hold in a public company do not include directorships held in a private company which is neither a holding nor subsidiary company of a public company.
167(4)	Additional grounds for vacation of office of a director may be provided in the Articles.
190(4)	The provisions relating to contract of employment with managing or whole-time directors does not apply to a private company.
197(1)	Total managerial remuneration payable by a private company, to its directors, including managing director and whole-time director, and its manager in respect of any financial year may exceed eleven percent of the net profits.

As per section 462 *(1)*, the Central Government may in public interest, by notification, direct that any of the provisions of this Act, shall not apply to such class or classes of companies or shall apply to the class or classes of companies with such exceptions, modifications and adaptations as may be specified in the notification. Therefore, the Central Government may grant further privileges/exemptions to Private Companies by issuing a notification.

Special Obligations of a Private Company

In addition to the restrictions imposed on Private Companies as contained in Section 2(68) of the Companies Act, a private company owes certain special obligations as compared to a public company, which are as follows:

A private company, while filing its annual return with the Registrar of Companies as required by Section 92, must also send with this return, a certificate stating that:

(i) The company has not, since the date of the closure of the last financial year with reference to which the last return was submitted or in the case of a first return since the date of the incorporation of the company, issued any invitation to the public to subscribe for any securities of the company;

(ii) Where the annual return discloses the fact that the number of members, except in case of a one person company, of the company exceeds two hundred, the excess consists wholly of persons who under second proviso to clause (ii) of sub-section (68) of section 2 (i.e., the person who is or were in the employment of the Co.) of the Act are not to be included in reckoning the number of two hundred;

(iii) The company continued to be a Private Company during the financial year.

Consequences of Alteration of the Articles of Private Companies

As per proviso to section 14(1), where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under section 2(68), the company shall, as from the date of such alteration, cease to be a private company. In such a case, it shall be treated as a public company from the date of alteration of its articles.

1.4.3 Further Classification of Private Company into One Person Company and Small Company

The Dr. JJ Irani committee had recommended that "Company Law should therefore recognize a multiple classification of companies." In line with the above said recommendation, under the Companies Act, 2013, a private company can further be classified into a One Person Company and Small Company.

One Person Company (OPC)

With the implementation of the Companies Act, 2013, a single person could constitute a company, under the One Person Company (OPC) concept. The new Companies Act, 2013 has done away with redundant provisions of the previous Companies Act, 1956, and provides for a new entity in the form of one person company (OPC), while empowering the Central Government to provide a simpler compliance regime for small companies.

The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entreprenеurship. In India, in the year 2005, the JJ Irani Expert Committee recommended the formation of OPC.

It had suggested that such an entity may be provided with a simpler legal regime through exemptions so that the small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliance. OPC is a one shareholder corporate entity, where legal and financial liability is limited to the company only.

Difference between a Sole Proprietorship and an OPC

The fundamental difference between a sole proprietorship and an OPC is the way liability is treated in the latter. A one-person company is different from a sole proprietorship because it is a separate legal entity that distinguishes between the promoter and the company.

The promoter's liability is limited in an OPC in the event of a default or legal issues. On the other hand, in sole proprietorships, the liability is not restricted and extends to the individual and his or her entire assets.

Box 1.1: Position of OPC in India under the Companies Act, 2013

The Companies Act, 2013 classifies companies on the basis of their number of members into One Person Company, private company and public company. As stated above, a private company requires a minimum of 2 members. In other words, a One Person Company is a kind of private company having only one member

As per section 2(62) of the Companies Act, 2013, "One Person Company" means a company which has only one person as a member. Section 3(1)(c) lays down that a company may be formed for any lawful purpose by one person, where the company to be formed is to be One Person Company that is to say, a private company. In other words, one person company is a kind of private company. A One person company shall have a minimum of one director.

Therefore, a One Person Company will be registered as a private company with one member and one director. By virtue of section 3(2), an OPC may be formed either as a company limited by shares or a company limited by guarantee, or an unlimited liability company.

Rule 3 of Companies (Incorporation) Rules, 2014 - One Person Company—

1. Only a natural person who is an Indian citizen and resident in India:

   (a) shall be eligible to incorporate a One Person Company;

   (b) shall be a nominee for the sole member of a One Person Company.

   Explanation: For the purposes of this rule, the term "Resident in India" means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.

3. Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such company by virtue of his being a nominee in that One Person Company, such person shall meet the eligibility criteria specified in sub rule *(2)* within a period of one hundred and eighty days.

4. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.

5. Such company cannot be incorporated or converted into a company under section 8 of the Act.

6. Such company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporates.

7. No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company, except threshold limit (paid up share capital) is increased beyond fifty lakh rupees or its average annual turnover during the relevant period exceeds two crore rupees.

Small Company

As recommended by the Dr. JJ Irani Committee, the concept of small companies has been introduced in the companies, Act, 2013. The recommendation of the Irani committee in this regard was as under:

The Committee sees no reason why small companies should suffer the consequences of regulation that may be designed to ensure balancing of interests of stakeholders of large, widely held corporates.

Company law should enable simplified decision making procedures by relieving such companies from select statutory internal administrative procedures.

Such companies should also be subjected to reduced financial reporting and audit requirements and simplified capital maintenance regimes. Essentially the regime for small companies should enable them to achieve transparency at a low cost through simplified requirements. Such a framework may be applied to small companies through exemptions, consolidated in the form of a Schedule to the Act

Small company is a new form of private company under the companies Act, 2013.

A classification of a private company into a small company is based on its size i.e., paid up capital and turnover. In other words, such companies are small sized private companies.

As per section 2(85) "small company" means a company, other than a public company:

(i) Paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than five crore rupees, or

(ii) Turnover of which as per its last profit and loss account does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than twenty crore rupees: Provided that nothing in this definition shall apply to:

   (a) a holding company or a subsidiary company;

   (b) a company registered under section 8; or

   (c) a company or body corporate governed by any special Act.

1.4.4 Public Company

By virtue of Section 2*(71)*, a public company means a company which:

(a) Is not a private company;

(b) Has a minimum paid-up share capital of five lakh rupees or such higher paid-up capital, as may be prescribed.

Provided that a company which is a subsidiary of a company, not being a private company, shall be deemed to be public company for the purposes of this Act even where such subsidiary company continues to be a private company in its articles.

As per section 3 *(1) (a)*, a public company may be formed for any lawful purpose by seven or more persons, by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of registration. A public

company may be said to be an association consisting of not less than 7 members, which is registered under the Act.

In principle, any member of the public who is willing to pay the price may acquire shares in or debentures of it. The securities of a public company may be quoted on a Stock Exchange.

The number of members is not limited to two hundred. It may be noted that in case of a public company, the articles do not contain the restrictions provided in Sections 2*(68)* of the Act. As per section 58*(2)*, the securities or other interest of any member in a public company shall be freely transferable.

However, any contract or arrangement between two or more persons in respect of transfer of securities shall be enforceable as a contract. The concept of free transferability of shares in public and private companies is very succinctly discussed in the case of *Western Maharashtra Development Corpn. Ltd. V. Bajaj Auto Ltd [2010] 154 Com Cases 593 (Bom)*. It was held that the Companies Act, makes a clear distinction in regard to the transferability of shares.

Distinction between private and public company

Following are the main points of distinction between a private and a public company:

1. In the case of a private company minimum number of persons to form a company is two while it is seven in the case of a public company.
2. In case of a private company the maximum number of members must not exceed fifty whereas there is no such restriction on the maximum number of members in case of a public company.
3. In private company the right to transfer shares is restricted, whereas in case of public company the shares are freely transferable.
4. A private company cannot issue a prospectus, while a public company may, through prospectus, invite the general public to subscribe for its shares or debentures.
5. A private company can commence business immediately after receiving the certificate of incorporation, while a public company can commence business only when it receives a certificate to commence business from the Registrar.
6. A private company need not hold a statutory meeting but a public company must hold a statutory meeting and file a statutory report with the Registrar.
7. The directors of a private company are not required to file with the Registrar written consent to act as directors or sign the memorandum of association or enter into a contract for their qualification shares. But the directors of a public company must file with the Registrar their written consent to act as directors, must sign the memorandum and must enter into a contract for their qualification shares.
8. Directors of a private company may be appointed by a single resolution, but it is not so in case of a public company.
9. Directors of a private company are not required to retire by rotation, but in case of a public company, at least two-third of the directors must retire by rotation.
10. The number of directors in a private company may be increased to any extent without the permission of the Central Government, but in case of a public company if the number of directors is to be more than twelve then the approval of the Central Government is necessary.

11. Two members have to be personally present to form the quorum in a private company but in a public company this number is five members.
12. In a private company, there are no restrictions on managerial remuneration
13. In addition to the above, a private company enjoys some special privileges. A public company enjoys no such privileges.
14. A private company cannot issue share warrants.

1.4.5 Limited Company

As per section 3*(2)*, a company formed under this Act may be either

(a) A company limited by shares; or

(b) A company limited by guarantee; or

(c) An unlimited company.

The term 'Limited Company' means a company limited by shares or by guarantee. The liability of the members, in the case of a limited company, may be limited with reference to the nominal value of the shares, respectively held by them or to the amount which they have respectively guaranteed to contribute in the event of winding up of the company.

Accordingly, a limited company can be further classified into:

(a) Company limited by shares, and

(b) Company limited by guarantee. Companies Limited by Shares

As per section 2*(22)*, "company limited by shares" means a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them.

Accordingly, no member of a company limited by shares can be called upon to pay more than the nominal value of the shares held by him. If his shares are fully paid-up, he has nothing more to pay.

But in the case of partly-paid shares, the unpaid portion is payable at any time during the existence of the company on a call being made, whether the company is a going concern or is being wound up.

This is the essence of a company limited by shares and is the most common form in existence. Companies Limited by guarantee as per section 2*(21)* "company limited by guarantee" means a company having the liability of its members limited by the memorandum to such amount as the members may respectively undertake to contribute to the assets of the company in the event of its being wound up.

Clubs, trade associations and societies for promoting different objects are examples of such a company. It should be noted that a special feature of this type of company is that the liability of members to pay their guaranteed amounts arises only when the company has gone into liquidation and not when it is a going concern

A guarantee company may or may not have a share capital. As regards the funds, a guarantee company without share capital obtains working capital from other sources, e.g. fees or grants. But a guarantee company having a share capital raises its initial capital from its members, while the normal working funds would be provided from other sources, such as fees, charges, subscriptions, etc.

The Memorandum of Association of every guarantee company must state that every member of the company undertakes to contribute to assets of the company in the event of its being wound up while he is a member for the payment of the debts and liabilities

of the company contracted before he ceases to be a member, and of the charges, costs and expenses of winding up, and for adjustment of the rights of the contributories among themselves, such amount as may be required, not exceeding a specified amount. The Memorandum of a company limited by guarantee must state the amount of guarantee. It may be of different denominations.

In case of a guarantee company having share capital the shareholders have two-fold liability: to pay the amount which remains unpaid on their shares, whenever called upon to pay, and secondly, to pay the amount payable under the guarantee when the company goes into liquidation. The voting power of a guarantee company having share capital is determined by the shareholding and not by the guarantee.

A guarantee company must include the word "limited" or the words "private limited" as part of its name, and must register its articles, and it shall adopt the provisions of the Table 'G' and 'H' of Schedule I. It must also state the number of members with which it proposes to be registered, although the number can be increased by means of a resolution.

Section 4*(7)* states that any provision in the memorandum of articles, in the case of company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member shall be void.

1.4.6 Unlimited Company

As per section 2(92), "unlimited company" means a company not having any limit on the liability of its members. Thus, the maximum liability of the member of such a company, in the event of being wound up, might stretch upto the full extent of their assets to meet the obligations of the company by contributing to its assets.

However, the members of an unlimited company are not liable directly to the creditors of the company, as in the case of partners of a firm. The liability of the members is only towards the company and in the event of being wound up only the Liquidator can ask the members to contribute to the assets of the company which will be used in the discharge of the debts of the company.

An unlimited company may or may not have share capital. Under Section 18, a company registered as an unlimited company may subsequently re-register itself as a limited company, by altering its memorandum and articles of the company in accordance with the provisions of Chapter II of the Companies Act subject to the provision that any debts, liabilities, obligations or contracts incurred or entered into, by or on behalf of the unlimited company before such conversion are not affected by such changed registration.

1.4.7 Association Not For Profit

As per Section 4(1), the memorandum of a company shall state the name of the company with the last word "Limited" in the case of a public limited company, or the last words "Private Limited" in the case of a private limited company.

However, Section 8(1) permits the registration, under a licence granted by the Central Government, of associations not for profit with limited liability without being required to use the word "Limited" or the words "Private Limited" after their names.

This is of great value to companies not engaged in business like bodies pursuing charitable, educational or other purposes of great utility. The Central Government may grant such a licence if:

(i) It is intended to form a company for promoting commerce, art, science, sports, education, research, social welfare, religion, charity protection of environment or any such other object; and

(ii) The company prohibits payment of any dividend to its members but intends to apply its profits or other income in promotion of its objects.

Further under section 8(5) where it is proved to the satisfaction of the Central Government that a limited company registered under this Act or under any previous company law has been formed with any of the objects specified above and with the restrictions and prohibitions as mentioned aforesaid, it may, by licence, allow the company to be registered under this section subject to such conditions as the Central Government deems fit and to change its name by omitting the word "Limited", or as the case may be, the words "Private Limited" from its name and thereupon the Registrar shall, on application, in the prescribed form, register such company under this section and all the provisions of this section shall apply to that company.

The company is registered without paying any stamp duty on its Memorandum and Articles. On registration, the Association enjoys all the privileges of a limited company, and is subject to all its obligations, except, those in respect of which exemption by a notification is granted by the Central Government.

A licence may be granted by the Central Government under Section 8 of the Act on such conditions and subject to such regulations as it thinks fit and those conditions and regulations shall be binding on the body to which the licence is granted. The Central Government may direct that such conditions and regulations shall be inserted in the Memorandum, or in the Articles, or partly in the one and partly in the other.

A Company, which has been granted licence under Section 8 cannot alter the provisions of its Memorandum or articles except with the previous approval of the Central Government. A firm may be a member of the company registered under this section. A company registered under section 8 may convert itself into company of any other kind only after complying with such conditions as may be prescribed.

An association registered under the Act, which has been granted a licence under Sub-section (1) of Section 8 which is subject to all the obligations under the Act, except in some cases where the Central Government has issued some notifications directing exemption, to such licensed companies from various provisions of the Act, as specified in those notifications. It covers aspects such as shorter notice of general meetings, publication of name under section 12, etc.

The Central Government may by order at any time revoke the licence whereupon the word "Limited" or "Private Limited" as the case may be, shall have to be used as part of its name and the company will lose the exemptions that might have been granted by the Central Government.

However, the Central Government can do so only after providing such association an opportunity to be heard and the aggrieved association can challenge the order of the Central Government under Article 226 of the Constitution.

Further a copy of every such order has to be filed with the Registrar. It is permissible for the Central Government to grant exemption to a class or classes of companies from one or more of the provisions of the Act under Sub-section (1) of Section 462.

1.4.8 Government Companies

Section 2(45) defines a "Government Company" as any company in which not less than fifty one percent of the paid-up share capital is held by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

Notwithstanding all the pervasive control of the Government, the Government company is neither a Government department nor a Government establishment [Hindustan Steel Works Construction Co. Ltd. v. State of Kerala (1998) 2 CLJ 383].

Since employees of Government companies are not Government servants, they have no legal right to claim that the Government should pay their salary or that the additional expenditure incurred on account of revision of their pay scales should be met by the Government. It is the responsibility of the company to pay them the salaries [A.K. Bindal v. Union of India (2003) 114 Com Cases 590 (SC)].

When the Government engages itself in trading ventures, particularly as Government companies under the company law, it does not do so as a State but it does so in the essence as a company. A Government company is not a department of the Government.

1.4.9 Foreign Companies

As per section 2(42), "foreign company" means any company or body corporate incorporated outside India which;

(a) has a place of business in India whether by itself or through an agent, physically or through electronic mode; and

(b) conducts any business activity in India in any other manner. Sections 379 to 393 of the Act deal with such companies.

Section 380 of the Act lays down that every foreign company which establishes a place of business in India must, within 30 days of the establishment of such place of business, file with the Registrar of Companies for registration:

(a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company and, if the instrument is not in the English language, a certified translation thereof in the English language;

(b) the full address of the registered or principal office of the company;

(c) a list of the directors and secretary of the company containing such particulars as may be prescribed;

(d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;

(e) the full address of the office of the company in India which is deemed to be its principal place of business in India;

(f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;

(g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and

(h) any other information as may be prescribed. Every foreign company has to ensure that the name of the company, the country of incorporation, the fact of limited liability of members is exhibited in the specified places or documents as required under Section 382.

Section 381 requires a Foreign Company to maintain books of Account and file a copy of balance sheet and profit and loss account in prescribed form with ROC every calendar year. These accounts should be accompanied by list of place of business established by the foreign company in India.

Section 376 of the Companies Act, 2013 provides further that when a foreign company, which has been carried on business in India, ceases to carry on such business in India, it may be wound up as an unregistered company under Sections 375 to 378 of the Act, even though the company has been dissolved or ceased to exist under the laws of the country in which it was incorporated.

Section 379 provides that where not less than 50% of the paid-up share capital, whether equity or preference or partly equity and partly preference of a foreign company is held by one or more citizens of India or by one or more bodies corporate incorporated in India, whether singly or in the aggregate, such company shall comply with such provisions of this Act, as may be prescribed by the Central Government with regards to the business carried on by it in India, as if it were a company incorporated in India

As regards the applicability of the provisions of the Companies Act, 2013 to foreign companies the following provisions of Section 384 are to be noted:

(i) The provisions of Section 71 relating to Debenutes shall apply *mutatis mutandis* to a foreign company.

(ii) The provisions of Section 92 regarding (filing of annual returns) shall, subject to such exceptions, modifications or adaptations as may be made therein by the rules made under the Act, apply to a foreign company as they apply to a company incorporated in India.

(iii) The provisions of Section 128 relating to the (to the extent of requiring it to maintain at its principal place of business in India books of account with respect to moneys received and spent, sales and purchase made and assets and liabilities, in the course of or in relation to its business in India), Section 209A (inspection of accounts), Section 233A (Special audit), Section 233B (audit of cost accounts), Section 234-246 (investigations), so far as may be, apply only to the Indian business of a foreign company having an established place of business in India as they apply to a company incorporated in India.

(iv) The provisions of Chapter VI (Registration of Charges) shall apply *mutatis mutandis* to charges on properties which are created or acquired by any foreign company

(v) The provisions of Chapter XIV (Inspection, Inquiry and Investigation) shall apply *mutatis mutandis* to the Indian business of a foreign company as they apply to a company incorporated in India.

As per Section 386(c), having a share transfer office or share registration office will constitute a place of business.

In Tovarishestvo Manufacture Liudvig Rabenek, Re [1944] 2 All ER 556 it was held that where representatives of a company incorporated outside the country frequently stayed in a hotel in England for looking after matter of business, it was held that the company had a place of business in England. In a certain case, it was held that mere holding of property cannot amount to have a place of business. A

representative of a foreign company in India was merely receiving orders from customers, it was held that it was not a "place of business" [P.J. Johnson v. Astrofiel Armadom [1989] 3 Comp LJ 1].

The following activities are held as not constituting "carrying on of business":

1. Carrying small transactions.
2. Conducting meetings of shareholders or even directors.
3. Operating bank accounts.
4. Transferring of shares or other securities.
5. Operating through independent contractors.
6. Procuring orders.
7. Creating or financing of debts, charges, etc. on property.
8. Securing or collecting debts or enforcing claims to property of any kind.

1.4.10 Holding, Subsidiary Companies and Associate Companies

On the basis of control companies can be classified into holding, subsidiary and associate companies. Holding company As per Section 2 (46), holding company, in relation to one or more other companies, means a company of which such companies are subsidiary companies.

Subsidiary Company

Section 2 (87) provides that subsidiary company or subsidiary, in relation to any other company (that is to say the holding company), means a company in which the holding company:

(i) Controls the composition of the Board of Directors; or

(ii) Exercises or controls more than one-half of the total share capital either at its own or together with one or more of its subsidiary companies: Provided that such class or classes of holding companies, shall not have layers of subsidiaries beyond the prescribed limit (Proviso to be notified). For the above purpose:

   (a) A company shall be deemed to be a subsidiary company of the holding company even if the control referred to in sub-clause (i) or sub-clause (ii) is of another subsidiary company of the holding company;

   (b) The composition of a company's Board of Directors shall be deemed to be controlled by another company if that other company by exercise of some power exercisable by it at its discretion can appoint or remove all or a majority of the directors;

   (c) The expression "company" includes any body corporate.

Associate Company

As per Section 2(6), "Associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.

Explanation to Section 2(6) provides that "significant influence" means control of at least twenty percent of total share capital, or of business decisions under an agreement.

To add more governance and transparency in the working of the company, the concept of associate company has been introduced. It will provide a more rational and objective framework of associate relationship between the companies. Further, as per section 2 (76), Related party includes 'Associate Company'.

Hence, contract with Associate Company will require disclosure/approval/entry in statutory register as is applicable to contract with a related party.

1.4.11 Investment Companies

As per explanation (a) to Section 186, "Investment Company" means a company whose principal business is the acquisition of shares, debentures or other securities. An investment company is a company, the principal business of which consists in acquiring, holding and dealing in shares and securities.

The word 'investment', no doubt, suggests only the acquisition and holding of shares and securities and thereby earning income by way of interest or dividend, etc.

But investment companies in actual practice earn their income not only through the acquisition and holding but also by dealing in shares and securities i.e., to buy with a view to sell later on at higher prices and to sell with a view to buy later on at lower prices.

If a company is engaged in any other business to an appreciable extent, it will not be treated as an investment company. The following two sets of legal opinions are quoted below as to the meaning of an investment company:

(i) According to one set of legal opinion, an "investment company" means company which acquires and holds shares and securities with an intent to earn income only from them by holding them.

On the other hand, another school of legal opinion holds that "an Investment Company means a company, which acquires shares and securities for earning income by holding them as well as by dealing in such shares and other securities".

(ii) According to Section 2(10A) of the Insurance Act, 1938, an investment company means a company whose principal business is the acquisition of shares, stocks, debentures or other securities.

1.4.12 Producer Companies

Section 465(1) of the Companies Act, 2013 provides that the Companies Act, 1956 and the Registration of Companies (Sikkim) Act, 1961 (hereafter in this section referred to as the repealed enactments) shall stand repealed.

However, proviso to Section 465(1) provides that the provisions of Part IX A of the Companies Act, 1956 shall be applicable mutatis mutandis to a Producer Company in a manner as if the Companies Act, 1956 has not been repealed until a special Act is enacted for Producer Companies.

In view of the above provision, Producer Companies are still governed by the Companies Act, 1956. Companies (Amendment) Act, 2002 had added a new Part IX A to the main Companies Act, 1956 consisting of 46 new Sections from 581A to 581ZT.

According to the provisions as prescribed under Section 581 A (1) of the Companies Act, 1956, a producer company is a body corporate having objects or activities specified in Section 581 B and which is registered as such under the provisions of the Act. The membership of producer companies is open to such people who themselves are the primary producers, which is an activity by which some agricultural produce is produced by such primary producers.

1.4.13 Dormant Companies

The Companies Act, 2013 has recognized a new set of companies called as dormant companies. As per Section 455 (1) where a company is formed and registered under

this Act for a future project or to hold an asset or intellectual property and has no significant accounting transaction, such a company or an inactive company may make an application to the Registrar in such manner as may be prescribed for obtaining the status of a dormant company.

Explanation appended to Section 455(1) says that for the purposes of this section:

(i) "inactive company" means a company which has not been carrying on any business or operation, or has not made any significant accounting transaction during the last two financial years, or has not filed financial statements and annual returns during the last two financial years;

(ii) "significant accounting transaction" means any transaction other than:

(a) Payment of fees by a company to the Registrar;

(b) Payments made by it to fulfil the requirements of this Act or any other law;

(c) Allotment of shares to fulfil the requirements of this Act: and

(d) Payments for maintenance of its office and records.

As per Section 455(2), the Registrar on consideration of the application shall allow the status of a dormant company to the applicant and issue a certificate in such form as may be prescribed to that effect. Section 455(3) provides that the Registrar shall maintain a register of dormant companies in such form as may be prescribed.

According to Section 455(4), in case of a company which has not filed financial statements or annual returns for two financial years consecutively, the Registrar shall issue a notice to that company and enter the name of such company in the register maintained for dormant companies.

Further a dormant company shall have such minimum number of directors, file such documents and pay such annual fee as may be prescribed to the Registrar to retain its dormant status in the register and may become an active company on an application made in this behalf accompanied by such documents and fee as may be prescribed [Section 455(5)].

The Registrar shall strike off the name of a dormant company from the register of dormant companies, which has failed to comply with the requirements of this section [Section 455(6)].

1.4.14 Public Financial Institutions

According to Section 2 (72), "Public financial institution" means:

(i) The Life Insurance Corporation of India, established under Section 3 of the Life Insurance Corporation Act, 1956;

(ii) The Infrastructure Development Finance Company Limited, referred to in clause (vi) of Sub-section (1) of Section 4A of the Companies Act, 1956 so repealed under Section 465 of this Act;

(iii) Specified company referred to in the Unit Trust of India (Transfer of Undertaking and Repeal) Act, 2002;

(iv) Institutions notified by the Central Government under Sub-section (2) of Section 4A of the Companies Act, 1956 so repealed under Section 465 of this Act;

(v) Such other institution as may be notified by the Central Government in consultation with the Reserve Bank of India: However, no institution shall be so notified unless:

(a) It has been established or constituted by or under any Central or State Act: or

(b) Not less than fifty-one percent of the paid-up share capital is held or controlled by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments.

1.4.15 Statutory Corporations

A Company formed under an Act of Parliament or State Legislature is called a Statutory Company/Corporation.

The special enactment contains its constitution, powers and scope of its activities. Change in its structure is possible only by a legislative amendment. Such companies are usually formed to carry on the work of some special public importance and for which the undertaking requires extraordinary powers, sanctions and privileges.

A major objective for incorporating statutory corporations is to serve public interest. The need for establishing a statutory corporation is that the State wishes to enter a field of human activity which has traditionally been, or will in normal course be, undertaken by non-official persons and groups.

Such companies do not use the word "limited" as part of their names, e.g., Reserve Bank of India, LIC, etc. However, in respect of Insurance, Banking, Electricity Supply or Electricity Generation companies and other companies governed by any special Act which are incorporated and registered under the Companies Act, the provisions of Insurance Act, Banking Regulation Act, Electricity Act and such special Act will prevail, respectively, when they are inconsistent with the provisions of the Companies Act, 2013, applicable generally.

1.5 THE COMPANIES ACT, 1956 – BASED ON BHABHA COMMITTEE RECOMMENDATIONS

The Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations. The Act came into force on 1st April, 1956. This Companies Act was based largely on the recommendations of the Company Law Committee (Bhabha Committee) which submitted its report in March, 1952.

This Act was the longest piece of legislation ever passed by our Parliament. Amendments have been made in this Act periodically. The Companies Act, 1956 consisted of 658 Sections and 15 Schedules.

Full and fair disclosure of various matters in prospectus; detailed information of the financial affairs of company to be disclosed in its account; provision for intervention and investigation by the Government into the affairs of a company; restrictions on the powers of managerial personnel; enforcement of proper performance of their duties by company management; and protection of minority shareholders were some of the main features of the Companies Act, 1956.

The Companies Act, 1956 had undergone changes by amendments in 1960, 1962, 1963, 1964, 1965, 1966, 1967, 1969, 1971, 1977, 1985, 1988, 1996, 1999, 2000, 2002 (Amendment), 2002 (Second Amendment), and 2006. The Companies Act, 1956 was also amended pursuant to the enactment of the Depositories Act, 1996. Based on the recommendations of Shastri Committee, the Companies (Amendment) Act, 1960 introduced several new provisions relating to various aspects of company management which were overlooked in the 1956 Act.

The Companies (Amendment) Act, 1963 provided for the appointment of a Company's Tribunal and constitution of the Board of Company Law Administration.

It also empowered the Central Government to remove managerial personnel involved in cases of fraud, etc. Based on the recommendations of the Vivian Bose Commission, the Companies (Amendment) Act, 1965 introduced some major changes, such as clear definition of the main and subsidiary objects of a company in its Memorandum of Association; Strengthening the provisions relating to investigation into the affairs of the company, etc.

The Companies Act was further amended twice in 1966. Two important changes were introduced by the Companies (Amendment) Act, 1969. The institutions of managing agents and secretaries and treasurers were abolished with effect from April 3, 1970. Secondly, contributions by companies to any political party or for any political purpose were prohibited.

The Companies (Amendment) Act, 1974 which came into force from February 1, 1975 had introduced some important and major changes in the Companies Act, 1956. The object of the Amendment Act was to inject an element of public interest in the working of the corporate sector. The Companies (Amendment) Act of 1977 brought about certain changes in Sections 58A, 220, 293, 620 and 634A of 1956 Act.

The Companies (Amendment) Act, 1985: The amending Act substituted Section 293A of Companies Act, 1956 with a new section permitting Non-Government companies to make political contributions, directly or indirectly.

With a view that legitimate dues of workers rank pari passu with secured creditors in the event of closure of the company and rank above even the dues to Government, Sections 529 and 530 of the Companies Act, 1956, were amended and a new Section 529A was introduced.

The Companies (Amendment) Act, 1988: Based on the recommendations made by the Expert Committee (Sachar Committee), the Companies (Amendment) Act, 1988 substantially amended the Companies Act, 1956 in order to streamline some of the existing provisions of the Companies Act, 1956 and to ensure better working and administration of the Act.

The important changes introduced by the Amendment Act of 1988 were: Definition of Secretary brought in line with the definition of 'Company Secretary' in the Company Secretaries Act, 1980 and includes an individual possessing the prescribed qualifications.

The concept of company secretary in practice was introduced for the first time in the Companies Act. The Amended Act, among other things, also set up an independent Company Law Board to exercise such judicial and quasi-judicial functions, earlier being exercised either by the Court or the Central Government.

The Depositories Act, 1996 made the following major amendments to the Companies Act, 1956:

1. Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company.
2. Stamping of transfer instruments is not required where both the transferor and transferee are entered as beneficial owners in the records of a depository.
3. The securities of a company other than a private company have been made freely transferable.

   The transfer has to be effected immediately by the company/depository.

4. The register of members shall indicate the shares held by a member in Demat mode but such shares need not be distinguished by a distinctive number.
5. Company to give in the offer document option to the investor to ask for issue of securities in Demat mode.

The Companies (Amendment) Act, 1999 made the following major changes to the Companies Act, 1956:

- Companies allowed to issue Sweat Equity shares and to buy-back their own securities.
- Facility for nomination provided for the benefit of share/debenture/deposit holders.
- An Investor Education and Protection Fund to be established.
- National Advisory Committee on Accounting Standards for companies to be established.
- Prior approval of Central Government not required for inter-corporate investment/lending proposals subject to certain conditions.

Further the Companies (Amendment) Act, 2000 made the following major amendments:

1. Private Companies and Public Companies to have a minimum paid-up capital of Rupees one lakh and five lakh respectively.
2. Change of place of registered office from the jurisdiction of one Registrar of Companies to another Registrar of Companies within the same state requires confirmation from the Regional Director.
3. Provisions relating to deemed public companies became inoperative and a new provision relating to conversion of a public company to a private company inserted in the Companies Act, 1956.
4. SEBI gives powers regarding issue and transfer of securities and non-payment of dividend by listed public companies.
5. Certain measures included for protecting the interest of small deposit holders in a company.
6. Preferential offer/Private placement of securities to 50 (fifty) persons or more treated as public issue. This shall not apply to a preferential offer made by public financial institutions and NBFCs.
7. Provisions relating to shelf-prospectus and information memorandum, issue of equity share capital with differential rights as to dividend, voting or otherwise included
8. Every listed company making initial public offer of any security for a sum of Rupees ten crores or more will have to issue the same only in a dematerialised form.

The Companies (Amendment) Act, 2002 and Companies (Second Amendment) Act, 2002 made the following changes to the Companies Act, 1956:

1. New Part IXA consisting of Section 581A to 581ZT relating to Producer Companies inserted.
2. The existing Company Law Board is proposed to be dissolved and in its place a National Company Law Tribunal (Tribunal) is to be constituted.
3 Appeals against the orders of the Tribunal can be filed with the Appellate Tribunal. Further appeals against the orders of the Appellate Tribunal would lie to the Supreme Court.

4. The Board for Industrial and Financial Reconstruction is to be abolished and SICA will be repealed.
5. Transfer of all the powers from the BIFR to the Tribunal.
6. Transfer of certain powers of the High Court to the Tribunal.
7. Greater role for professionals in the administration of Company Law.
8. Transfer of powers relating to winding up, mergers and amalgamations from Court to the Tribunal.

The Companies (Amendment) Act, 2006 inserted new Sections 610B, 610C, 610D and 610E and also certain sections pertaining to Director Identification Number (DIN). Salient features of the provisions of Companies (Amendment) Act, 2006 are as follows: DIN to be obtained by all existing directors and every other person, intending to become a director.

- The applications, balance sheet, prospectus, return, declaration, memorandum and articles of association, particulars of charges or any other particulars or document required to be filed or delivered, are to be filed in electronic form.
- The document, notice, any communication or intimation, required to be served or delivered under the Act to the Registrar of Companies, should be served or delivered through electronic form.
- Applications, balance sheet, prospectus, return, register, MOA and AOA, particulars of charges or any other document and return filed shall be maintained by Registrar in electronic form.
- Central Government may provide such value added services through the electronic form.
- All the provisions of Information Technology Act, 2000 relating to the electronic records, in so far as they are not inconsistent with the Companies Act, shall apply to the records in electronic form.

1.6 EVOLUTION OF THE COMPANIES ACT, 2013

The Companies Act, 1956 was enacted with the object to amend and consolidate the law relating to companies. This Act provided the legal framework for corporate entities in India and was a mammoth legislation.

As the corporate sector grew in numbers and size of operations, the need for streamlining this Act was felt and as many as 24 amendments had taken place since then. Major amendments were made through the Companies (Amendment) Act, 1988 after considering the recommendations of the Sachar Committee, and then again in 1998, 2000 and in 2002 through the Companies (Second Amendment) Act, 2002.

Unsuccessful attempts were made in 1993 and 1997 to replace the present Act with a new law. Companies (Amendment) Bill, 2003 containing important provisions relating to Corporate Governance and aimed at achieving competitive advantage was also introduced.

Till some time back Companies Act, 1956, was the principal legislation governing the corporate sector in India. However, several changes had taken place in the national and international economic environment after the enactment of this Act during the last two to three decades.

Thus, modernisation of company law governing setting up and functioning of enterprises, structures for sharing risk and reward, governance and accountability to the investors and other stakeholders and structural changes in the law commensurate

with global standards had become critical for governing and guiding a vibrant corporate sector and business environment. To frame a law that enables companies to achieve global competitiveness in a fast changing economy, the Government had taken up a fresh exercise for a comprehensive revision of the Companies Act, 1956, albeit through a consultative process.

As a first step in this direction, a Concept Paper on Company Law drawn up in the legislative format was exposed for public viewing on the electronic media so that all interested parties may not only express their opinions on the concepts involved but may also suggest formulations on various aspects of Company Law.

The response to the concept paper on Company Law was tremendous. The Government, therefore, felt it appropriate that the proposals contained in the Concept Paper and suggestions received thereon be put to merited evaluation by an independent Expert Committee.

A Committee was constituted on 2nd December, 2004 under the Chairmanship of Dr. J J Irani, Director, Tata Sons, with the task of advising the Government on the proposed revisions to the Companies Act, 1956 with the objective to have a simplified compact law that will be able to address the changes taking place in the national and international scenario, enable the adoption of internationally accepted best practices as well as provide adequate flexibility for timely evolution of new arrangements in response to the requirements of ever-changing business models. The Committee submitted its report to the Government on 31st May, 2005.

The Companies Act, 2013 has introduced new concepts supporting enhanced disclosure, accountability, better board governance, better facilitation of business and so on. It includes the following aspects:

- Associate company
- One person company
- Small company
- Dormant company
- Independent director
- Women director
- Resident director
- Special court
- Secretarial standards
- Secretarial audit
- Class action
- Registered values
- Rotation of auditors
- Vigil mechanism
- Corporate social responsibility
- Cross border mergers
- Prohibition of insider training
- Global depositories receipts

Check Your Progress

Fill in the blanks.

1. _____ is a voluntary association of individuals for profit, having a capital divided into transferable shares.
2. A company being an _____has no body similar to natural person and as such it cannot sign documents for itself.
3. In _____ the members are liable for the company's debts in proportion to their respective interests in the company and their liability is unlimited. Such companies may or may not have share capital.
4. The fundamental difference between a _____ and an OPC is the way liability is treated in the latter.
5. A _____ must include the word "limited" or the words "private limited" as part of its name, and must register its articles.

1.7 LET US SUM UP

- The word 'company' is derived from the Latin word (Com = with or together; panis = bread), and it originally referred to an association of persons who took their meals together.
- In the legal sense, a company is an association of both natural and artificial persons incorporated under the existing law of a country. A company has a separate legal entity from the persons constituting it.
- The main characteristics of a company are corporate personality, limited liability, perpetual succession, separate property, transferability of shares, common seal, capacity to sue and be sued, contractual rights, limitation of action, separate management, termination of existence, etc.
- Company Law in India has been modelled on the English Company Law.
- In India after independence, the Companies Act, 1956 was enacted with a view to consolidate and amend the earlier laws relating to companies and certain other associations.
- Companies Act, 2013 was passed by the Lok Sabha and Rajya Sabha on 18th December and 8th August, 2013 respectively. It received the assent of the Hon'ble President of India on 29th August, 2013 and was notified in the Gazette of India on 30th August, 2013. The Companies Act, 2013 has replaced the Companies Act, 1956.
- Major amendments to Companies Act, 1956 had been made by the Depositories Act, 1996 the Companies (Amendment) Acts, 1988, 1999, 2000, 2002 & 2006 apart from various other Amendments Acts.
- From the point of view of incorporation, companies can be classified as chartered companies, statutory companies and registered companies. Companies can be categorized as unlimited companies, companies limited by guarantee and companies limited by shares.
- Companies can also be classified as public companies, private companies, one person companies, small companies, associations not for profit having licence under Section 8 of the Act, Government companies, foreign companies, holding companies, subsidiary companies, associate companies, investment companies and producer companies.

1.8 LESSON END ACTIVITY

Answer the following questions:

1. Four persons are the only members of a private company. All of them go for a pleasure trip in a car and due to an accident all the four die. Does the private company exist?
2. The members of a private limited company consist of 'A' and 'B' who are also its directors. On 4th August, 2012 'A' left India for a foreign business tour and on 28th August, 2012 he died abroad. On 1st September, 2012 'B' purchased on credit ₹ 10,000 worth of goods from 'C' on behalf of the company. 'C' now proposes to make 'B' personally liable for the payment of the debt. Is 'B' liable?

1.9 KEYWORDS

Company: Company is an association of persons who contribute to its capital and is registered under Companies Act, 1956.

Private Companies: Private companies are companies which by their Articles of Association (i) Restrict the maximum number of members to fifty (ii) Restrict the transferability of shares (iii) Put restriction on inviting public to buy its shares (iv) Minimum paid up capital of such company is one lakh rupees.

Public Companies: Companies that are not private companies are public companies.

Producer Company: A producer company is a body corporate having objects or activities specified in Section 581B of Companies Act, 1956 and which is registered as such under the provisions of the Act.

Investment Company: Investment Company means a company whose principal business is the acquisition of shares, debentures or other securities.

1.10 QUESTIONS FOR DISCUSSION

1. Define company. Explain in brief its characteristics.
2. State in brief the various kinds of companies which can be registered under the Companies Act, 2013.
3. Define a private company and state the special privileges which it enjoys under the Companies Act, 2013.
4. Discuss in brief disadvantages and obligations of a private company.
5. Define a public company and distinguish it from a private company.
6. What is a Government Company?
7. Discuss in brief the law relating to statutory corporations.
8. What is a foreign company?

Check Your Progress: Model Answer

1. Joint Stock Company
2. Artificial Person
3. Unlimited Liability Companies
4. Sole proprietorship
5. Guarantee Company

1.11 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi

G. Vijayaragavan Iyengar, *Introduction to Banking*, 2007, Excel Books. New Delhi, India.

K.C. Garg, R.C., Chawla, Vijay Gupta, *Company Law*, Kalyani Publishers, Ludhiana

Company Law Journal, *Company Law Journal (India) Pvt. Ltd.*, New Delhi

LESSON

2

FORMATION OF A COMPANY

CONTENTS

2.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Elucidate and explicate the meaning of promotion, legal position of the promoter, its duties, steps in company promotion, types, functions, and necessary documents required to be submitted
- Describe the incorporation of business and issue of certificate of incorporation by registrar
- Outline the subscription of capital
- Discuss the commencement of business

2.1 INTRODUCTION

A Company comes into existence when a group of people come together with a view of forming an association to exploit the business opportunities by bringing together; men, material, money and management.

To fully understand the process one can divide the formalities into four distinct stages, which are:

(i) Promotion;

(ii) Incorporation;

(iii) Subscription of capital; and

(iv) Commencement of business.

These stages are appropriate from the point of view of formation of a public limited company. As far as the private limited companies are concerned only the first two stages mentioned above are appropriate.

In other words, a private company can start its business immediately after obtaining the certificate of incorporation. As it is prohibited to raise funds from public, it does not need to issue a prospectus and complete the formality of minimum subscription.

A public company, on the other hand, goes through the capital subscription stage and then receives the certificate of commencement. Thus, it has to undergo all the four stages.

In this lesson, we shall discuss these four stages in the formation of a company in some detail.

2.2 PROMOTION

Promotion is the first stage in the formation of a company. It is a person or a group of persons who generates the idea of incorporating a company and takes all the effective steps to incorporate it.

Promoter: [Section 2(69)]:- It means a person

- Who has been named in prospectus or is identified by the company in annual return.
- Who has control over the affairs of the company, directly or indirectly.
- In accordance with whose advice, directions or instructions the BOD is accustomed to act.

According to C.W. Gresternbeg, *Promotion may be defined as the discovery of business opportunities and the subsequent organisation of funds, property and managerial ability into a business concern for the purpose of making profits therefrom.*

According to H.E. Heagland, *Promotion is the process of creating a specific business enterprise. Its scope is very broad, and numerous individuals are frequently asked to make their contributions to the programme. Promotion begins when someone gives serious consideration to the formulation of the ideas upon which the business in question is to be based. When the corporation is organised and ready for operation, the major function of promotion comes to an end.*

According to Guthmann and Dougall, *Promotion starts with the conception of the idea from which the business is to evolve and continues down to the point at which the business is full, ready to begin operations in a going concern.*

It involves conceiving a business opportunity and taking an initiative to form a company so that practical shape can be given to exploit the available business opportunity.

Thus, it begins with somebody having discovered a potential business opportunity. Any person or a group of persons or even a company may have discovered an opportunity.

If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company. They have the power of defining the object of the company and deciding various matters for the company proposed to be incorporated like (i) Purposes for which the company is to be incorporated (ii) Proposed scale of operations (iii) Capital involved (iv) Directors, etc.

The promoters can select the type of company as they wish to form themselves into private company, public company, non-profit making company, etc.

2.2.1 Legal Position of the Promoter

Following are the legal position of the promoter:

(i) ***Not an agent:*** He cannot be an agent of the company for which he promotes because his principle (company) does not exists at the time when he acts on its behalf.

(ii) ***Not a trustee:*** A promoter is not the trustee of the company because there cannot be any trust before the company comes into its existence.

(iii) ***Fiduciary position/relation to the company:*** The promoters stand in the fiduciary relation to the company i e., a relation of trust, confidence and good faith.

Hence, a promoter is neither an agent nor a trustee of the company but he is in a fiduciary relationship with the company.

Caselet

Lindley L.J. in Lydney and Wigpool Iron Ore Co. v. Bird, (1866) 33 Ch. D 85, described the position of a promoter as follows:

"Although not an agent for the company, nor a trustee for it before its formation, the old familiar principles of law of agency and of trusteeship have been extended and very properly extended to meet such cases. It is well settled that a promoter of a company is accountable to it for all money secretly obtained by him from it just as the relationship of the principal and agent or the trustee and cestui que trust had really existed between him and the company when the money was obtained".

Similarly, it was observed in Lagunas Nitrate Co. v. Lagunas Syndicate, (1899) 2 Ch 392 that "promoters" stand in a fiduciary relation to the company they promote and to those persons whom they induce to become shareholders in it.

The promoters undoubtedly stand in a fiduciary position. They have in their hands the creation and moulding of the company. They have the power of defining how and when and in what shape and under whose supervision it shall come into existence and begin to act [As per Lord Cairns in Erlanger v. New Sombrero Phosphate Co., (1873) 3 App. Case 1218-1236].

In a series of similar cases under the English Law it has been held that the promoters, being in a fiduciary position, may not make, either directly or indirectly, any profit at the expense of the company and that if he does make a profit in disregard of this rule, the company can compel him to account for it.

The promoters can be compelled to surrender the secret profits [Emma Silver Mining Co v. Grant, (1879) 11 Ch. D and Erlanger v. New Sombrero Phosphate Co, (supra)]

2.2.2 Duties of a Promoter

The Companies Act, 2013, contains some provisions regarding the duties of promoters. The fiduciary duties of a promoter includes:

(a) As per section 102(4), where as a result of the non-disclosure or insufficient disclosure in any explanatory statement annexed to the notice of a general meeting, by a promoter, director, manager, if any, or other key managerial personnel, any benefit accrues to such promoter, director, manager or other key managerial personnel or their relatives, either directly or indirectly, the promoter, director, manager or other key managerial personnel, as the case may be, shall hold such benefit in trust for the company, and shall, without prejudice to any other action being taken against him under this Act or under any other law for the time being in force, be liable to compensate the company to the extent of the benefit received by him.

In the case of default in complying with above provisions, every promoter, director, manager or other key managerial personnel who is in default shall be punishable with fine which may extend to 50,000 rupees or five times the amount of benefit accruing to the promoter, director, manager or other key managerial personnel or any of his relatives, whichever is more. [Sub-section (5) of Section 102]

The above provision is based on the principle that a promoter cannot make either directly or indirectly, any profit at the expense of the company he promotes, without the knowledge and consent of the company and that if he does so, in disregard of this rule, the company can compel him to account for it. In relation to disclosure it may be noted that part disclosure will also attract the same consequences.

A promoter is not forbidden to make profit but he is barred from making any secret profit. He may make a profit out of promotion with the consent of the company in the same way as an agent may retain a profit obtained through his agency with his principal's consent.

Caselet

In Gluckstein v. Barnes, (1900) A.C. 240 it was held that where a promoter makes some profits in connection with a transaction to which company is a party and does not make full disclosure of his profits: the company has the right to affirm the contracts and promoter should handover his profits to the company.

(b) A promoter is not allowed to derive a profit from the sale of his own property to the company unless all material facts are disclosed. If a promoter contracts to sell his own property to the company without making a full disclosure, the company may either repudiate the sale or affirm the contract and recover the profit made out of it by the promoter. Either way the dishonest promoter is deprived of his advantage.

Caselet

In Erlanger v. New Sombrero Phosphate Co., (1878) 3 A.C. 1218, a syndicate of which E was the head purchased an island containing mines of phosphate for £ 5,000. E then formed a company to buy this island. A contract was made between X a nominee of the syndicate and the company for its purchase at £ 1,10,000. The details of the sale were not disclosed to the shareholders or to the independent Board of directors. The company now sought to rescind the contract of sale. It was held that as there had been no disclosure by the promoters of the profit they were making, the company was entitled to rescind the contract.

In case, therefore, the promoter wishes to sell his own property to the company, he should either disclose the fact:

(i) To an independent Board of directors;

(ii) In the articles of association of the company;

(iii) In the prospectus; or to the existing; and

(iv) Intended shareholders directly.

In addition to disclosing secret profits, a promoter has the duty to disclose to the company any interest he has in a transaction entered into by him.

(c) As per section 13(8), a company, which has raised money from public through prospectus and still has any unutilised amount out of the money so raised, shall not change its objects for which it raised the money through prospectus unless a special resolution is passed by the company and the dissenting shareholders shall be given an opportunity to exit by the promoters and shareholders having control in accordance with regulations to be specified by the Securities and Exchange Board.

(d) As per section 27(2), the dissenting shareholders being those shareholders who have not agreed to the proposal to vary the terms of contracts or objects referred to in the prospectus, shall be given an exit offer by promoters or controlling shareholders at such exit price, and in such manner and conditions as may be specified by the Securities and Exchange Board by making regulations in this behalf.

(e) As per section 167(3), where all the directors of a company vacate their offices under any of the disqualifications specified in sub-section (1), the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in the general meeting.

(f) As per section 168(3), where all the directors of a company resign from their offices, or vacate their offices under section 167, the promoter or, in his absence, the Central Government shall appoint the required number of directors who shall hold office till the directors are appointed by the company in general meeting.

(g) As per section 284(1), the promoters, directors, officers and employees, who are or have been in employment of the company or acting or associated with the company shall extend full cooperation to the Company Liquidator in discharge of his functions and duties during winding up by the Tribunal.

Promoter's duties under the Indian Contract Act

Promoters' duties cannot depend on a contract because at the time the promotion begins; the company is not incorporated, and so cannot contract with its promoters.

The promoter's duties must be the same as that of a person acting on behalf of another individual without a contract of employment. If he does make any misrepresentation in a prospectus he may be held guilty of fraud under Section 17 of the Indian Contract Act, 1872 and would be held liable for damages.

Termination of Promoters' Duties

It is a general opinion that a promoter completes his duty the moment the company, that he promotes, is incorporated or when the Board of directors is appointed. But, in reality it continues until the company has acquired the property for which it was formed to manage and has raised its initial share capital, and the Board takes over the management of the affairs of the company from the promoters.

Remedies Available to the Company against the Promoter

If a promoter makes a secret profit or does not disclose it, the company has got a remedy against him. This varies according to the circumstances, which can be divided into two possible situations.

1. Where the promoter was not in a fiduciary position when he acquired the property which he is selling to the company, but only when he sold it to the company.

   If a person acquires property or has had it before he takes any active steps in the promotion of a company and sells it to the company at a profit, he is entitled to retain that profit. Here the promoter, as in Salomon's case, has had the property for a period of time

   He can hardly be said to be in a fiduciary relation to the company. As long as he makes a full disclosure of the fact that the property is his and he is the real vendor, he may sell it to the company at a profit. If, however, he fails to disclose this fact the company is entitled either to rescind the contract or claim damages for breach of duty of disclosure.

2. Where the promoter was in fiduciary position when he acquired the property and when he sold it to the company.

   This may happen in any of the following circumstances:

   (a) Where the promoter bought property with a view to sell it to the company which he intends to promote, he occupies fiduciary position vis-a-vis the company. He must disclose all the facts to the company.

   (b) Where the promoter resells property to the company at an increased price, the property which he purchased after he has commenced to act in the capacity of a promoter, he cannot retain the profit which he has not disclosed to the company.

   (c) Where a person is a promoter for acquiring the property for the company, the rules of agency will apply, so that any profit he makes will belong to the company.

3. Where, the promoter bought the property with a view to sell it to the company he promotes, the company may either:

   (a) Rescind the contract and if he has made a profit on some ancillary transaction that may also be recovered; or

   (b) Retain the property, paying no more for it than what the promoter has paid, depriving him of his profit; or

   (c) Where the above remedies would be inappropriate, such as when the property has been altered so as to render recession impossible and the promoter has already received his inflated price, the company may sue him for misfeasance (breach of duty to disclose). The measure of damages will be the difference between the market value of the property and the contract price.

2.2.3 Steps in Company Promotion

The work of promotion of a company involves four stages namely;

1. Discovery of an idea and Preliminary investigation
2. Detailed investigation
3. Assembling and
4. Financing the promotion

1. ***Discovery of an Idea and Preliminary Investigation:*** The promoter starts out with an idea to start some business either in a new field which has not been commercially exploited or in some existing lines of manufacture or business. He makes a preliminary investigation to find out whether it is worthwhile to make a detailed investigation. He makes a rough estimate of probable revenues and expenditure.

2. ***Detailed Investigation:*** The promoter needs to make a detailed investigation of his idea with the assistance of many experts like engineer, chemist, market analyst, financial expert, management consultant, etc.

   On the basis of the reports of these experts, the promoters would be in a position to know the capital requirements, place of location, size of the unit, demand condition in the market, price of product, cost of production, probable return on capital, etc.

   A detailed investigation will help the promoter to decide whether the estimated income will be adequate to take care of the estimated cost of production and compensation to the owner for risks and services.

3. ***Assembling:*** After a detailed investigation, if the promoter is satisfied with the practicability and profitability of the proposed concern, he starts assembling the proposition.

   'Assembling' means getting the support and consent of some other persons to act as directors or founders, arranging for patents, a suitable site for the company machinery and equipment and making contracts for filling the positions.

4. ***Financing the Proposition:*** After assembling, the proposition, the promoter prepares a 'prospectus' to present to the public and to under writers to persuade them to, finance the 'proposition'.

   A prospectus contains complete details of the proposition and also the reports of various experts who have investigated the proposition. The promoter also takes steps to incorporate the company, and to secure the certificate to commence the business.

   For incorporating the company and also for obtaining the certificate to commence business, the promoter has to fulfill many legal formalities.

2.2.4 Types of Promoters

The task of business promotion may be carried out by an individual, a firm, a body corporate or a banker. Based on the nature of their operation the promoters can be classified into the following categories:

(a) ***Professional Promoters:*** These promoters are specialists in promoting new business ventures. They do it on a whole time basis as their occupation or profession. They initiate all the steps in establishing new enterprises and find out the persons who can finance it.

   After completing all the formalities they pass on the management to their owners or shareholders and then move to another new venture.

(b) ***Financial Promoters:*** These promoters float companies only during favourable conditions in the securities market. They have the financial capacity and look forward to opportunities for new investment.

(c) ***Technical Promoters:*** These promoters are technical experts in different fields. They make use of their specialised knowledge, experience and training in promoting new business. They generally charge fees for their services.

(d) ***Entrepreneurial Promoters:*** They are the people who conceive new ideas of business, take necessary steps to set up the business unit to give it a shape and ultimately control and manage it. Most promoters in India (like Tata, Birla, Ambanics) fall in this category.

(e) ***Specialised Institutions:*** There are certain financial institutions which provide financial assistance and guidance in launching new ventures and often collaborate with new entrepreneurs to promote new business. They also provide management and technical expertise to the existing enterprises.

(f) ***Government:*** Both the central and state governments also act as promoters in most cases where the new business is floated either in public sector or joint sector which involve a huge amount of capital and risk. HMT, ONGC, SAIL, BHEL are glaring examples of units set up by the government.

2.2.5 Functions of a Promoter

The important functions of promoters may be listed as below.

(i) ***Identification of Business Opportunity:*** The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential. Such opportunity is then analysed to see its technical and economic feasibility.

(ii) ***Feasibility Studies:*** It may not be feasible or profitable to convert all identified business opportunities into real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start.

Depending upon the nature of the project, the following feasibility studies may be undertaken, with the help of the specialists like engineers, chartered accountants etc., to examine whether the perceived business opportunity can be profitably exploited.

(a) *Technical feasibility:* Sometimes an idea may be good but technically not possible to execute. It may be so because the required raw material or technology is not easily available. For example, in our earlier story suppose Avtar needs a particular metal to produce the carburettor. If that metal is not produced in the country and because of poor political relations, it can not be imported from the country which produces it, the project would be technically unfeasible until arrangements are made to make the metal available from alternative sources.

(b) *Financial feasibility:* Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up. For example, one may think that developing townships is very lucrative. It may turn out that the required funds are in several crores of rupees, which cannot be arranged by floating a company by the promoters. The idea may be abandoned because of the lack of financial feasibility of the project.

(c) *Economic feasibility*: Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being profitable is very little. In such cases as well, the idea may have to be abandoned. Promoters usually take the help of experts to conduct these studies. It may be noted that these experts do not become promoters just because they are assisting the promoters in these studies.

Only when these investigations throw up positive results, the promoters may decide to actually launch a company.

(iii) ***Name Approval:*** Having decided to launch a company, the promoters have to select a name for it and submit an application to the registrar of companies of the state in which the registered office of the company is to be situated, for its approval. The proposed name may be approved if it is not considered undesirable.

It may happen that another company exists with the same name or a very similar name or the preferred name is misleading, say, to suggest that the company is in a particular business when it is not true.

In such cases the proposed name is not accepted but some alternate name may be approved.

Therefore, three names, in order of their priority are given in the application to the Registrar of Companies. Performa Application for availability of names (Form 1A) is given.

FORM NO. 1-A

The Companies Act, 1961

(Application Form for Availability of Names*)

The Registrar of Companies,

_____

_____

Sir,

Subject: Availability of Names-information Furnishing of:

We, the following applicants are desirous of forming a company to be registered under the Companies Act, 1956, in the State Union Territory of:

1. Name and full address of the person(s) applying for availability, of the name

   (IN BLOCK LETTERS).

2. Proposed name of the Company.

3. State whether Public or Private.

4. In case the proposed name mentioned in item 2 is not available, 3 names to be considered, in the order of preference.

5. Main objectives of the proposed company.

6. Name and address of the prospective Directors of Promoters, etc.

7. Particulars of the names and situation of registered office of other companies in the same group or under the same management.

8. Proposed authorised capital.

9. Please furnish particulars and results of any application moved to this or any other Registrar previously for availability of name.

Contd...

10. Particulars of remittance of fee.

Situation_____ _____

Dated_____ Signature of the applicant

* *Refer Rule 4 A of the Companies/Central Government's/General Rules and Forms, 1956*

(iv) ***Fixing up Signatories to the Memorandum of Association:*** Promoters have to decide about the members who will be signing the Memorandum of Association of the proposed company.

Usually the people signing memorandum are also the first Directors of the Company.

Their written consent to act as Directors and to take up the qualification share in the company is necessary.

(v) ***Appointment of Professionals:*** Certain professionals such as mercantile bankers, auditors, etc. are appointed by the promoters to assist them in the preparation of necessary documents which are required to be with the Registrar of Companies.

The names and addresses of shareholders and the number of shares allotted to each are submitted to the Registrar in a statement called return of allotment.

(vi) ***Preparation of Necessary Documents:*** The promoter takes up steps to prepare certain legal documents which have to be submitted under the law, to the Registrar of the Companies for getting the company registered.

These documents are Memorandum of Association, Articles of Association and Consent of Directors.

2.2.6 Documents Required to be Submitted

Following are the documents required:

a. ***Memorandum of Association:*** Memorandum of Association is the most important document as it defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association. The Memorandum of Association contains different clauses which are given as follows:

(i) *The name clause:* This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.

(ii) *Registered office clause:* This clause contains the name of the state, in which the registered office of the company is proposed to be situated. The exact address of the registered office is not required at this stage but the same must be notified to the Registrar within thirty days of the incorporation of the company.

(iii) *Objects clause:* This is probably the most important clause of the memorandum. It defines the purpose for which the company is formed. A company is not legally entitled to undertake an activity, which is beyond the objects stated in this clause. The object clause is divided into two sub-clauses, which are:

- The main objects: The main objects for which the company is formed are listed in this sub-clause. It must be observed that an act which is either essential or incidental for the attainment of the main objects of the

company is deemed to be valid, although it may not have been stated explicitly in the sub-clause.

- Other objects: Objects not included in the main objects could be stated in this sub-clause. However, if a company wishes to undertake a business included in this sub-clause, it has to either pass a special resolution or pass an ordinary resolution and get central government's approval for the same.

(iv) *Liability clause:* This clause limits the liability of the members to the amount unpaid on the shares owned by them. For example, if a shareholder has purchased 1000 shares of ₹10 each and has already paid ₹6 per share, his/her liability is limited to ₹4 per share. Thus, even in the worst case, he/she may be called upon to pay ₹4, 000 only.

(v) *Capital clause:* This clause specifies the maximum capital which the company will be authorised to raise through the issue of shares. The authorised share capital of the proposed company along with its division into the number of shares having a fixed face value is specified in this clause. For example, the authorised share capital of the company may be ₹25 with divided into 2.5 lakh shares of ₹10 each. The said company cannot issue share capital in excess of the amount mentioned in this clause.

(vi) *Association clause:* In this clause, the signatories to the Memorandum of Association state their intention to be associated with the company and also give their consent to purchase qualification shares. The Memorandum of Association must be signed by atleast seven persons in case of a public company and by two persons in case of a private company. A copy of a Memorandum of Association is given.

MEMORANDUM OF ASSOCIATION

(Specimen)

1. *Name:* The name of the company is Excellent Educational Services Limited. It is hereinafter referred to as EES Ltd.
2. *Registered Office:* The Registered office of the company shall be situated in the NCT of Delhi and at present it is at: Sri Aurobindo Marg, New Delhi-16.
3. **(A) Main Objectives:**
   (a) To engage in the design, development and delivery of world class service products in the sphere of education for domestic as well as global markets
   (b) To establish and strengthen presence/market share in the various segments representing various stages in the education/re-education process in the life-long learning context, viz., identification of prospects, curriculum-design, pedagogy, examination and evaluation, anticipating societal/market needs, content-delivery, placement services and human resource development and renewal
   (c) To develop, publish/produce teaching, training and study materials, journals, periodicals, reports, books, monographs and other multilingual literature/multimedia products for promoting the objectives of the company.
   (d) To organise programmes, conferences, lectures, seminars, symposia and workshops on issues impacting education, industry, business and society.

Contd

(B) Ancillary Objectives:

(a) To develop special competencies and capabilities for designing, developing and delivering service products for persons with physical and mental disabilities;

(b) To liaise and network with various individuals and institutions in government and non-government sectors and fostering mutually beneficial relationship in the field of education;

(c) To host a website for virtual learning;

(d) To build up a research and reference library and to undertake documentation services;

(e) To own, purchase and lease movable and immovable property in furtherance of the aims and objectives of the company;

(f) To offer prizes, grants, stipends and scholarships in furtherance of the objectives of company;

(g) To provide a forum for raising, discussing and resolving of issues, problems and challenges in the field of education; and

(h) To do generally all such other lawful things as are conducive or incidental to the attainment of the above objectives.

4. ***Liability Clause:*** Liability of the members would be limited to the amount of unpaid value of the share

5. ***Capital Subscription Clause:*** The company shall be registered with a capital of ₹2.5 crore divided into ₹25 lakh shares of ₹10 each.

We the following persons voluntarily agreed to be the signatories to the Memorandum of Association:

Ravi Kumar	Sanjiv Singh
Usha	Nitima Mishra
Sanjay Singh	Ashish
Anoop	Saurav kumar

The name and address of the company signatures to Memorandum have been modified.

b. ***Articles of Association:*** Articles of Association are the rules regarding internal management of a company. These rules are subsidiary to the Memorandum of Association and hence, should not contradict or exceed anything stated in the Memorandum of Association.

A public limited company may adopt Table A which is a model set of articles given in the Companies Act. Table A is a document containing rules and regulations for the internal management of a company. If a company adopts Table A, there is no need to prepare separate Articles of Association. For companies not adopting Table A, a copy of the Articles of Association, stamped and duly signed by signatories to the Memorandum of Association is required for registration.

c. ***Consent of Proposed Directors:*** Apart from the Memorandum and Articles of Association, a written consent of each person named as a director is required confirming that they agree to act in that capacity and undertake to buy and pay for qualification shares, as mentioned in the Articles of Association.

d. ***Agreement:*** The agreement, if any, which the company proposes to enter with any individual for appointment as its Managing Director or a whole time Director or Manager is another document which is required to be submitted to the Registrar for getting the company registered under the Act.

e. ***Statutory Declaration:*** A declaration stating that all the legal requirements pertaining to registration have been complied with is to be submitted to the Registrar with the above mentioned documents for getting the company registered under the law. This statement can be signed by an advocate of High Court or Supreme Court or by a Chartered Accountant in full time practice or by a person named in the articles as a director or manager or secretary of the company. Performa of statutory declaration is given under.

PERFORMA FOR STATUTORY DECLARATION

"FORM NO.1"

The Companies Act, 1956

Declaration of Compliance with requirements of the Companies Act, 1956 on Application for Registration of a Company.

PURSUANT TO SECTION 33 (2)

NAME OF THE COMPANY : _____.

PRESENTED BY : _____.

CHARTERED ACCOUNTANT.

I, _____(NAME OF CA)_____Partner of_____ (NAME OF CA FIRM & ITS ADDRESS)_____, do solemnly and sincerely declare that I am a Chartered Accountant in whole time practice in India, who is engaged in the formation of the company "M/s – — — ———————— PRIVATE LIMITED".

And that all the requirements of the Companies Act, 1956 and the rules thereunder in respect of matters precedent to the registration of the said company and incidental thereto have been complied with and I make this solemn declaration conscientiously believing the same to be true.

PLACE : NEW DELHI (NAME OF CA)

DATED : CHARTERED ACCOUNTANTS

f. ***Payment of fee:*** Along with the above-mentioned documents, necessary fees have to be paid for the registration of the company. The amount of such fees shall depend on the authorised share capital of the company.

2.3 INCORPORATION OF BUSINESS

After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company.

The application for registration must be accompanied with certain documents about which we have already discussed in the previous sections. These may be briefly mentioned again:

1. The Memorandum of Association duly stamped, signed and witnessed. In case of a public company, atleast seven members must sign it. For a private company however the signatures of two members are sufficient. The signatories must also give information about their address, occupation and the number of shares subscribed by them.
2. The Articles of Association duly stamped and witnessed as in case of the Memorandum. However, as stated earlier, a public company may adopt Table A, which is a model set of Articles, given in the Companies Act. In that case a statement in lieu of the prospectus is submitted, instead of Articles of Association.
3. Written consent of the proposed directors to act as directors and an undertaking to purchase qualification shares.
4. The agreement, if any, with the proposed Managing Director, Manager or whole-time Director.
5. A copy of the Registrar's letter approving the name of the company.
6. A statutory declaration affirming that all legal requirements for registration have been complied with. This must be signed by an advocate of a High Court or Supreme Court or a signatory to the Memorandum of Association or a Chartered Accountant or Company Secretary in whole time practice in India.
7. A notice about the exact address of the registered office may also be submitted along with these documents.

   However, if the same is not submitted at the time of incorporation, it can be submitted within 30 days of the receipt of the certificate of incorporation.
8. Documentary evidence of payment of registration fees.

The Registrar upon submission of the application along with the required documents has to be satisfied that the documents are in order and that all the statutory requirements regarding the registration have been complied with. However, it is not his duty to carry out a thorough investigation about the authenticity of the facts mentioned in the documents.

When the Registrar is satisfied, about the completion of formalities for registration, a Certificate of Incorporation is issued to the company, which signifies the birth of the company. The certificate of incorporation may therefore be called the birth certificate of the company. With effect from November 1st, 2000, the Registrar of Companies allots a CIN (Corporate Identity Number) to the Company.

2.3.1 Effect of the Certificate of Incorporation

A company is legally born on the date printed on the Certificate of Incorporation. It becomes a legal entity with perpetual succession on such date. It becomes entitled to enter into valid contracts.

The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company.

Imagine, what would happen to an unsuspecting party with which the company enters into a contract, if it is later found that the incorporation of the company was improper and hence invalid.

Therefore, the legal situation is that once a Certificate of Incorporation has been issued, the company has become a legal business entity irrespective of any flaw in its registration.

The Certificate of Incorporation is thus conclusive evidence of the legal existence of the company. Some interesting examples showing the impact of the conclusiveness of the Certificate of Incorporation are as under:

(a) Documents for registration were filed on 6th January. Certificate of Incorporation was issued on 8th January.

But the date mentioned on the Certificate was 6th January. It was decided that the company was in existence and the contracts signed on 6th January were considered valid.

(b) A person forged the signatures of others on the Memorandum. The Incorporation was still considered valid.

Thus, whatever be the deficiency in the formalities, the Certificate of Incorporation once issued, is a conclusive evidence of the existence of the company.

Even when a company gets registered with illegal objects, the birth of the company cannot be questioned. The only remedy available is to wind it up.

Because the Certificate of Incorporation is so crucial, the Registrar has to go very carefully before issuing it.

On the issue of Certificate of Incorporation, a private company can immediately commence its business. It can raise necessary funds from friends, relatives or through private arrangement and proceed to start business.

A public company, however, has to undergo two more stages in its formation.

SPECIMEN OF CERTIFICATE OF INCORPORATION

I hereby certify that ..... (name of the company) is this day incorporated under the Companies Act 1956, and that the Company is limited.

Given under my hand at Delhi, this seventh day of November, two thousand and five.

Fees: Deed Stamp ₹ .. ..

Stamp Duty on Capital ₹ ....

Seal

Sd/-

Registrar of Companies

Delhi

Corporate Identity Number of Company : 1352 of 2005

2.3.2 Issue of Certificate of Incorporation by Registrar

Section 7(2) states that the Registrar on the basis of documents and information filed under sub-section (1) of section 7, shall register all the documents and information referred to in that sub-section in the register and issue a certificate of incorporation in the prescribed form to the effect that the proposed company is incorporated under this Act.

From the date of incorporation mentioned in the certificate of incorporation, such subscribers to the memorandum and all other persons, as may, from time to time, become members of the company, shall be a body corporate by the name contained in the memorandum, capable of exercising all the functions of an incorporated company under this Act and having perpetual succession and a common seal with power to acquire, hold and dispose of property, both movable and immovable, tangible and intangible, to contract and to sue and be sued, by the said name. The subscribers would become the members of the company.

2.3.3 Conclusive Evidence

A Certificate of Incorporation given by the Registrar in respect of any association shall be conclusive evidence that all the requirements of the Act have been complied with in respect of registration and matters precedent and incidental thereto, and that the association is a company authorised to be registered and duly registered under the Act.

The Certificate of Incorporation is conclusive evidence that everything is in order as regards to registration and that the company has come into existence from the earliest moment of the day of incorporation stated therein with rights and liabilities of a natural person, competent to enter into contracts [Jubilee Cotton Mills Ltd. v. Lewis, (1924) (A.C. 958)]. The validity of the registration cannot be questioned after the issue of the certificate.

In *Moosa v. Ebrahim ILR* (1913) 40 Cal. 1 (P.C.) the Memorandum of Association of a company was signed by two adults and by a guardian of the other 5 subscribers, who were minors. The Registrar, however, registered the company and issued under his hand a Certificate of Incorporation. It was contended that this Certificate of Incorporation should be declared void

Lord Macnaughten 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 purpose. Thus, the certificate prevents anyone from alleging that the company does not exist".

It is for the purpose of incorporation only that the certificate was made conclusive by the legislature and the certificate cannot legalise the illegal object contained in the Memorandum. Where the object of a company is unlawful, it has been held that the certificate of registration is not conclusive for this purpose, [*Performing Right Society Ltd. v. London Theatre of Varieties (1992) 2 KB 433*].

Allotment of Corporate identity number

Section 7(3) states that on and from the date mentioned in the certificate of incorporation issued under sub-section (2), the Registrar shall allot to the company a corporate identity number, which shall be a distinct identity for the company and which shall also be included in the certificate.

Documents of incorporation to be preserved

Section 7(4) states that the company shall maintain and preserve at its registered office copies of all documents and information as originally filed under sub-section (1) till its dissolution under this Act.

The Procedural aspects involved in incorporation of companies are briefly given below:

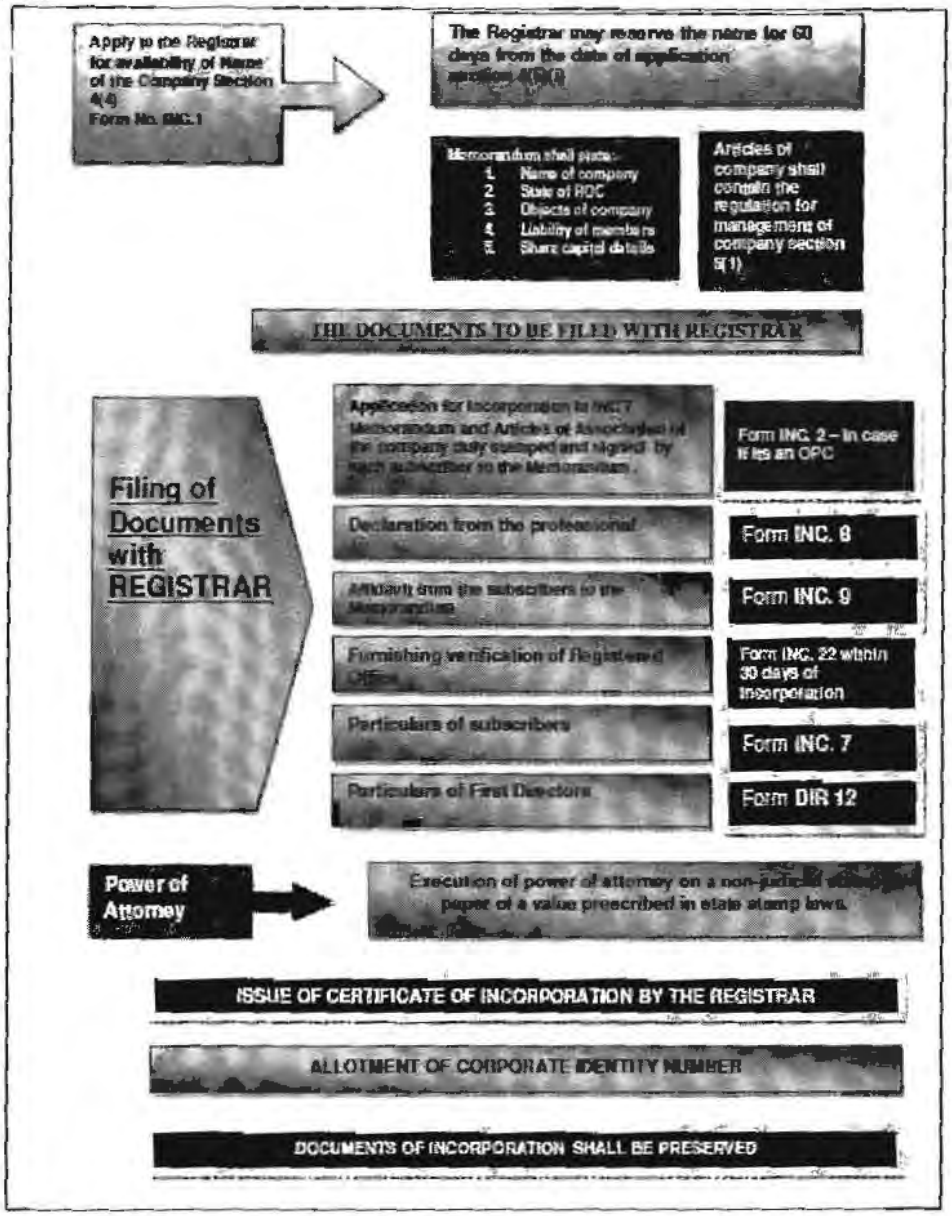


Figure 2.1: How to Incorporate a Company under the Companies Act, 2013

Punishment for furnishing false or incorrect information at the time of incorporation

The Companies Act, 2013 imposes severe punishment for incorporation of a company by furnishing false or incorrect information. The persons furnishing false or incorrect information shall be liable for following punishment:

(i) If any person furnishes any false or incorrect particulars of any information or suppresses any material information, of which he is aware in any of the documents filed with the Registrar in relation to the registration of a company, he shall be punishable for fraud under section 447 [Section 7(5)].

(ii) Without prejudice to the above liability, where, at any time after the incorporation of a company, it is proved that the company has been got incorporated by

furnishing any false or incorrect information or representation or by suppressing any material fact or information in any of the documents or declaration filed or made for incorporating such company, or by any fraudulent action, the promoters, the persons named as the first directors of the company and the persons making declaration under section 7(1)(b) shall each be punishable for fraud under section 447 [Section 7(6)].

2.4 SUBSCRIPTION OF CAPITAL

A public company can raise the required funds from the public by means of issue of shares and debentures. For doing the same, it has to issue a prospectus which is an invitation to the public to subscribe to the capital of the company and undergo various other formalities. The following steps are required for raising funds from the public:

(i) ***SEBI Approval:*** SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country has issued guidelines for the disclosure of information and investor protection.

A company inviting funds from the general public must make adequate disclosure of all relevant information and must not conceal any material information from the potential investors. This is necessary for protecting the interest of the investors.

Prior approval from SEBI is, therefore, required before going ahead with raising funds from public.

(ii) ***Filing of Prospectus:*** A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies. A prospectus is 'any document described or issued as a prospectus including 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 or debentures of, a body corporate'. In other words, it is an invitation to the public to apply for shares or debentures of the company or to make deposits in the company.

Investors make up their minds about investment in a company primarily on the basis of the information contained in this document. Therefore, there must not be a misstatement in the prospectus and all significant information must be fully disclosed.

(iii) ***Appointment of Bankers, Brokers, Underwriters:*** Raising funds from the public is a stupendous task. The application money is to be received by the bankers of the company. The brokers try to sell the shares by distributing the forms and encouraging the public to apply for the shares. If the company is not reasonably assured of a good public response to the issue, it may appoint underwriters to the issue. Underwriters undertake to buy the shares if these are not subscribed by the public. They receive a commission for underwriting the issue. Appointment of underwriters is not necessary.

(iv) ***Minimum Subscription:*** Before commencing the business, every public limited company must have to show that adequate funds have been raised from the public. So when the company gives the offer to the public to subscribe its shares, it must ensure that a minimum number of shares must be subscribed by the investors. This is called minimum subscription, which is 90% of the total number of shares offered to the public.

If the application money received is less than the minimum subscription, then the company must return all the application money of the investors and it cannot start its operation. To avoid this risk, the share issuing company may appoint underwriters, who undertake to buy the shares if these are not subscribed by the public. The underwriters perform their job on commission basis. This process of

appointing underwriters to ensure the minimum subscription of capital is known as Underwriting.

In order to prevent companies from commencing business with inadequate resources, it has been provided that the company must receive applications for a certain minimum number of shares before going ahead with the allotment of shares.

According to the Companies Act, this is called the 'minimum subscription'. The limit of minimum subscription is 90 percent of the size of the issue. Thus, if applications received for the shares are for an amount is less than 90 percent of the issue size, the allotment cannot be made and the application money received must be returned to the applicants.

(i) *Application to Stock Exchange:* An application is made to atleast one stock exchange for permission to deal in its shares or debentures. If such permission is not granted before the expiry of ten weeks from the date of closure of subscription list, the allotment shall become void and all money received from the applicants will have to be returned to them within eight days.

(ii) *Allotment of Shares:* In case the number of shares allotted is less than the number applied for, or where no shares are allotted to the applicant, the excess application money, if any, is to be returned to applicants or adjusted towards allotment money due from them. Allotment letters are issued to the successful allottees.

Return of allotment, signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment. A public company may not invite public to subscribe to its shares or debentures. Instead, it can raise the funds through friends, relatives or some private arrangements as done by a private company. In such cases, there is no need to issue a prospectus. A 'Statement in Lieu of Prospectus' is filed with the Registrar atleast three days before making the allotment.

2.5 COMMENCEMENT OF BUSINESS

If the amount of minimum subscription is raised through new issue of shares, a public company applies to the Registrar of Companies for the issue of Certificate of Commencement of Business. The following documents are required:

1. A declaration that shares payable in cash have been subscribed for and allotted up to the minimum subscription mentioned in the prospectus;
2. A declaration that every director has paid in cash, the application and allotment money on his shares in the same proportion as others;
3. A declaration that no money is payable or liable to become payable to the applicants because of the failure of the company to either apply for or obtain permission to deal in its securities on a stock exchange; and
4. A statutory declaration that the above requirements have been complied with. This declaration can be signed by a director or secretary of the company.

A public company raising funds privately, which has earlier filed a Statement in lieu of prospectus, has to submit only documents 2 and 4 listed above. The Registrar shall examine these documents.

If these are found satisfactory, a 'Certificate of Commencement of Business' will be issued. This certificate is conclusive evidence that the company is entitled to do business. With the grant of this certificate the formation of a public company is complete and the company can legally start doing business.

CERTIFICATE OF COMMENCEMENT OF BUSINESS

(Specimen)

I hereby certify that ..... ltd. of .... which was incorporated under The Companies Act, 1956, on the ..... day of..... 200..... and which has this day filed a statutory declaration in the prescribed form that the conditions of section 149 have been complied with, is entitled to commence business.

Given under my hand at .... this day of ..... two thousand..... .....

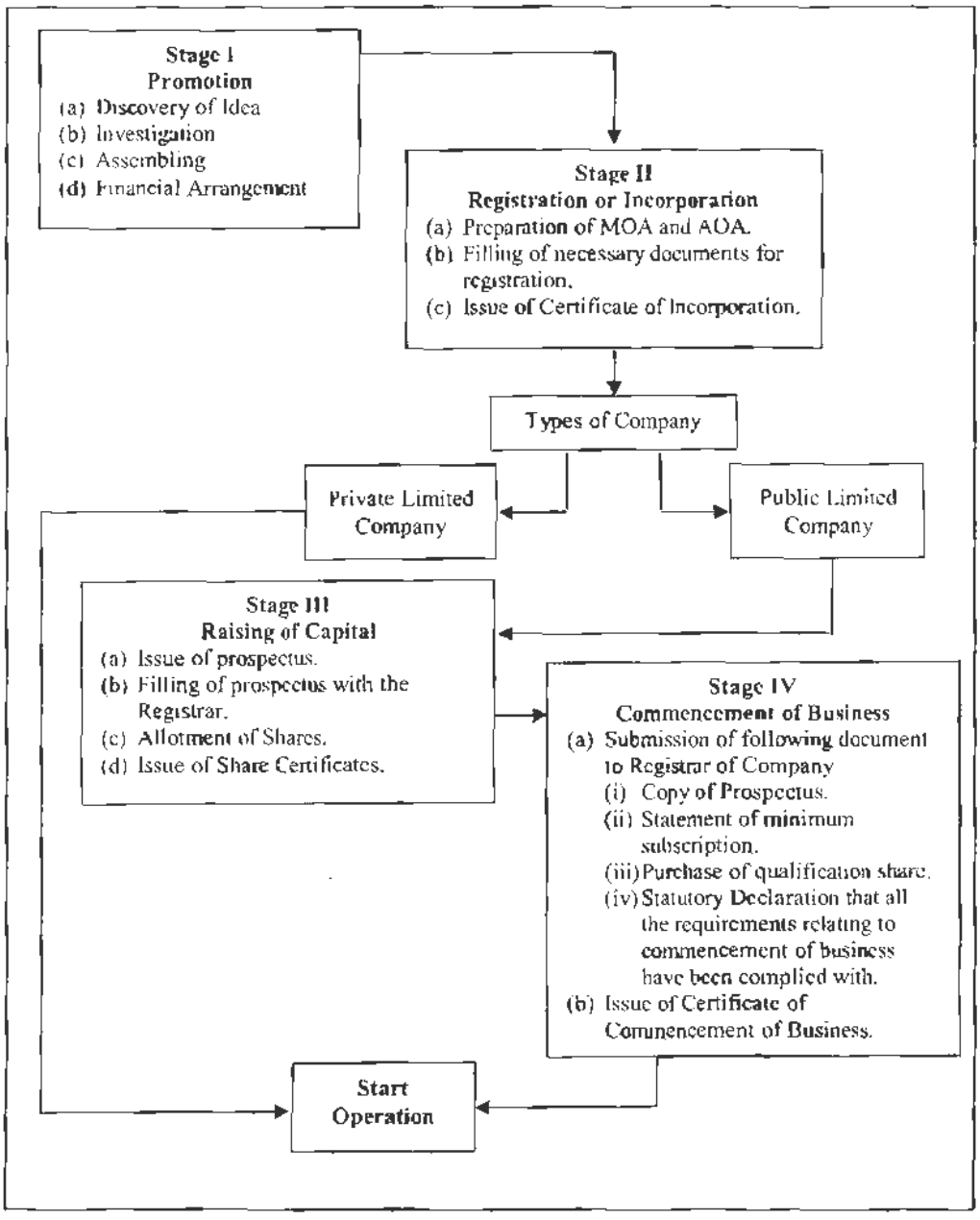
SEAL

Registrar

Joint Stock Companies
..... (State)

FORMATION OF A JOINT STOCK COMPANY

Flow Chart



Check Your Progress

Fill in the blanks.

1. _____ is a person or a group of persons who generates the idea of incorporating a company and takes all the effective steps to incorporate it.
2. _____float companies only during favourable conditions in the securities market.
3. The _____contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.
4. _____ are the rules regarding internal management of a company.
5. After completing the aforesaid formalities, promoters make an application for the _____of the company.

2.6 LET US SUM UP

- Promoters are the persons who conceive the idea of forming a company, and take the necessary steps to incorporate it by registration, provide it with share and loan capital and acquire the business or property which it is to manage.
- A promoter is neither an agent of, nor a trustee for the company. But he occupies a fiduciary position in relation to the company.
- Steps in Promotion of company

  (a) Discovery of Idea

  (b) Investigation and Verification

  (c) Assembling

  (d) Financing the Proposition
- A company comes into existence only when it is incorporated or registered with the Registrar of Companies. The promoter has to take the following steps for this purpose:

  (a) Approval of name,

  (b) Filing of Documents, and

  (c) Payment of Filing and registrations fees.
- After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company.
- The first few steps to be taken by a promoter in incorporating a company are to apply for availability of name of company, prepare the memorandum and articles of association and get them vetted, printed, stamped and signed.
- A private company can immediately start its business after receiving the Certificate of Incorporation. However, a public company can start its business only after getting the Certificate of Commencement of Business.

- Important documents prepared while forming a company:
  (a) Memorandum of Association
  (b) Articles of Association
  (c) Prospectus
- A private company raises funds from the members or borrowing from banks and others. A public company has to raise funds from the public by issuing a prospectus.
- If the amount of minimum subscription is raised through new issue of shares, a public company applies to the Registrar of Companies for the issue of Certificate of Commencement of Business.

2.7 LESSON END ACTIVITY

Name the following documents with example of any Indian company.

(a) The document issued by the company to the public to invite them to subscribe its share capital.

(b) The document that binds a member with the company, company with members and members with members.

(c) The document that contains rules for internal management of the company.

(d) The document that specifies the aims of the company.

(e) The document issued by the public company which does not want to issue a prospectus.

2.8 KEYWORDS

Promotion: It refers to all those activities that are required to be undertaken to establish a new business (may be a company).

Promoter: A promoter is a person or a group of persons who think of forming a company and take necessary steps for the same.

Memorandum of Association: It is a principal document in the formation of a company. It is called the charter of the company.

Articles of Association: It contains the various rules and regulations for the internal management of the company.

Prospectus: This document is prepared by the public limited companies. The purpose of its preparation is to invite the public to subscribe its shares and debentures.

Conclusive Evidence: Preponderant evidence that may not be disputed and must be accepted by a Court as a definitive proof of a fact.

2.9 QUESTIONS FOR DISCUSSION

1. Enumerate the steps for the promotion of a company.
2. Why is a prospectus issued by the public limited company?
3. List any two documents submitted for the registration of a company.
4. State the steps involved in promotion of a company.
5. State any two clauses of Memorandum of Association.

6. Define a prospectus and state its contents.
7. As a promoter, how will you obtain certificate of commencement of business? Explain in brief.
8. What is meant by Articles of Association. State its contents.
9. Explain in brief any two basic documents which are required to be filed in formation of a company.
10. Distinguish between Memorandum of Association and Articles of Association.

Check Your Progress: Model Answer

1. Promotion
2. Financial Promoters
3. Name Clause
4. Articles of Association
5. Incorporation

2.10 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi

S S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi

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Company Law Journal, *Company Law Journal (India) Pvt. Ltd.*, New Delhi.

UNIT II

LESSON

3

MEMORANDUM OF ASSOCIATION

CONTENTS

3.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Study in detail memorandum of association, its forms and contents
- Elucidate the name clause, registered office clause or situation clause and objects clause of memorandum
- Explicate the liability clause, capital clause and association clause
- Discuss the alteration of memorandum of association

3.1 INTRODUCTION

The memorandum and articles of association of a company are the most important documents for the formation of a company and for its functioning thereafter. The memorandum of association contains the name, situation of registered office, objects, capital and liability clauses. The articles are its bye-laws or rules and regulations that govern the management and internal affairs and the conduct of its business. Both the documents are required to be registered with the Registrar of Companies during incorporation.

The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. Thus, it defines as well as confines the powers of the company. If anything is done beyond these powers, that will be ultra vires (beyond powers of) the company and so void.

The memorandum serves a two-fold purpose. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities. Thus, the intending shareholder can find out the field in, or the purpose for which his money is going to be used by the company and what risk he is taking in making the investment. Also, anyone dealing with the company, say, a supplier of goods or money will know whether the transaction he intends to make with the company is within the objects of the company and not ultra vires its objects.

After reading this lesson, you would be able to understand the concept of Memorandum of Association their purpose, contents and registration. It also discusses the alterations that can be carried out in the Memorandum of Association and effect of such alterations. It also explains the legal effect of these documents. It also covers doctrine of indoor management and Alter Ego.

3.2 DETAILED STUDY OF MEMORANDUM OF ASSOCIATION

The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built.

It defines the scope of the company's activities and its relations with the outside world. The first step in the formation of a company is to prepare a document called the memorandum of association. In fact memorandum is one of the most essential pre-requisites for incorporating any form of company under the Act.

This is evidenced in Section 3 of the Act, which provides the mode of incorporation of a company and states that a company may be formed for any lawful purpose by seven or more persons, where the company to be formed is a public company; two or more persons, where the company to be formed is a private company; or one person, where the company to be formed is a One Person Company by subscribing their names or his name to a memorandum and complying with the requirements of this Act in respect of its registration.

To subscribe means to append one's signature or mark a document as an approval or attestation of its contents.

According to Section 2(56) of the Companies Act, 2013 "memorandum" means the memorandum of association of a company as originally framed and altered from time to time in pursuance of any previous company law or this Act. Section 4 of the Act specifies in clear terms the contents of this important document which is the charter of the company.

The memorandum of association of a company contains the objects to pursue which the company is formed. It not only shows the objects of formation but also determines the scope of its operations beyond which its actions cannot go. "THE MEMORANDUM OF ASSOCIATION", observed Palmer, "is a document of great importance in relation to the proposed company".

Caselet

In the celebrated case of Ashbury Railway Carriage & Iron Co. Ltd. v. Riche, (1875) L.R 7 H.L. 653, Lord Cairn observed: "The memorandum of association of a company is its charter and defines the limitations of the powers of the company.. ..... it contains in it both that which is affirmative and that which is negative. It states affirmatively the ambit and extent of vitality and powers which by law are given to the corporation, and it states negatively, if it is necessary to state, that nothing shall be done beyond that ambit... ... " [Egyptian Salt and Soda Co. Ltd. v. Port Said Salt Association Ltd (1931) A.C. 677].

3.2.1 Form and Contents

Section 4(6) of the Companies Act, 2013 provides that the memorandum of association should be in any one of the Forms specified in Tables A, B, C, D or E of Schedule I to the Act, as may be applicable in the case of the company or in Forms as near thereto as circumstances admit.

(i) The Form in Table A is applicable in the case of companies limited by shares;

(ii) The Form in Table B is applicable to companies limited by guarantee not having a share capital;

(iii) The Form in Table C is applicable to the companies limited by guarantee having a share capital;

(iv) The Form in Table D is applicable to unlimited companies not having a share capital;

(v) The Form in Table E is applicable to unlimited companies having a share capital. A company shall adopt any of the model Forms of the memorandum of association mentioned above, as may be applicable to it.

Section 15 requires the memorandum to be printed, divided into paragraphs, numbered consecutively and signed by atleast seven persons (two in the case of a private company) in the presence of atleast one witness, who will attest the signature.

Each of the members must take atleast one share and write opposite his name the number of shares he takes. Section 13 requires the memorandum of a limited company to contain:

(i) the name of the company, with 'limited' as the last word of the name in the case of a public company and 'private limited' as the last words in the case of a private company; (Name Clause),

(ii) the name of the State, in which the registered officer of the company is to be situated; (Situation Clause),

(iii) the objects of the company, stating separately 'Main objects' and 'other objects'; (objects clause),

Provided that nothing in this clause shall apply to a company registered under section 8;

(iv) the declaration that the liability of the members is limited; (Liability Clause):

- in the case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them; and
- in the case of a company limited by guarantee, the amount upto which each member undertakes to contribute:

- to the assets of the company in the event of its being wound-up while he is a member or within one year after he ceases to be a member, for payment of the debts and liabilities of the company or of such debts and liabilities as may have been contracted before he ceases to be a member, as the case may be; and
- **to the costs, charges and expenses of winding-up and for adjustment of the rights of the contributories among themselves.**

(v) the amount of the authorised share capital, divided into shares of fixed amounts; (Capital Clause),

- the amount of share capital with which the company is to be registered and the division thereof into shares of a fixed amount and the number of shares which the subscribers to the memorandum agree to subscribe which shall not be less than one share per subscriber; and
- the number of shares each subscriber to the memorandum intends to take, indicated opposite his name.

(vi) **in the case of a One Person Company, the name of the person who, in the event of the death of the subscriber, shall become the member of the company.**

According to section 4(7), any provision in the memorandum or articles, in the case of a company limited by guarantee and not having a share capital, purporting to give any person a right to participate in the divisible profits of the company otherwise than as a member, shall be void.

It is to be noted that the Companies Act, 2013 shall override the provisions in the memorandum of a company, if the latter contains anything contrary to the provisions in the Act (Section 6).

These contents of the memorandum are called compulsory clauses and are explained below:

MEMORANDUM OF ASSOCIATION [SECTION 4 READ WITH SCHEDULE I]

Name Clause	Situation Clause	Object Clause	Liability Clause	Capital Clause	Subscription Clause (stated in schedule I)
Application for name approval to be made in INC 1 Name of the company to indicate private or public. No use of name that will constitute an offence. No undesirable name as specified in Rule 8 of Companies (Incorporation) Rules. No identical name that resembles the	This specifies the state in which the registered office is situated. Companies to have registered office within 15 days of incorporation. Registrar to be intimated about the details of registered office within 30 days of incorporation or 15 days of change if any as the case may be in Form INC. 22.	Memorandum to state the object of the company proposed to be incorporated. The bifurcation of main, ancillary and other objects as required under Companies Act 1956 has been dispensed within Companies Act 2013.	This states that liability of the members is limited or unlimited. In case of a company limited by shares, that liability of its members is limited to the amount unpaid, if any, on the shares held by them (including premium if any) as against Companies Act, 1956	This must state the amount of the capital with which the company is registered. The shares into which the capital is divided must be of fixed amount and the no. of shares which the subscribers to the memorandum agree to subscribe to subscribers to which shall not be less than one share.	Subscribers agree to subscribe the prescribed no. of shares stated against their name in the memorandum. The statutory requirements regarding subscription of memorandum are that: 1. Each subscriber must take atleast 1 share. 2. Each subscriber must write opposite his name the no.

Contd...

name of an existing company.			where in it was limited to the amount unpaid on the face value of the share.	The capital is variously described as "Nominal", "Authorised".	of shares which he agreed to take.

3.3 THE NAME CLAUSE

The promoters are free to choose any suitable name for the company provided:

(a) The last word in the name of the company, if limited by shares or guarantee is 'limited' unless the company is registered under Section 25 as an 'association not for profit' [Section 13(1) (a) & Section 25].

(b) In the opinion of the Central Government, the name chosen is not undesirable [20(1)].

The Department of Company Affairs has issued guidelines for deciding availability of names. However, these are not exhaustive but only illustrative of what is considered an undesirable name under Section 20.

According to Section 4(2), the name stated in the memorandum shall not:

(a) be identical with or resemble too nearly to the name of an existing company registered under this Act or any previous company law; or

(b) be such that its use by the company:

(i) will constitute an offence under any law for the time being in force, or

(ii) is undesirable in the opinion of the Central Government.

Section 4(3) provides that without prejudice to the provisions of Section 4(2), a company shall not be registered with a name which contains:

(a) any word or expression which is likely to give the impression that the company is in any way connected with, or having the patronage of, the Central Government, any State Government, or any local authority, corporation or body constituted by the Central Government or any State Government under any law for the time being in force; or

(b) such word or expression, as may be prescribed, unless the previous approval of the Central Government has been obtained for the use of any such word or expression.

As per Section 4(4) a person may make an application, in such form (Form INC1) and manner and accompanied by such fee, as may be prescribed, to the Registrar for the reservation of a name set out in the application as:

(a) the name of the proposed company; or

(b) the name to which the company proposes to change its name.

Section 4(5)(i) lays down that upon receipt of an application under sub-section (4), the Registrar may, on the basis of information and documents furnished along with the application, reserve the name for a period of 60 days from the date of the application.

As stated above, Section 4(2) provides that the name stated in the memorandum shall not be such that its use by the company, in the opinion of the Central Government, is undesirable. A name which is identical to or too nearly resembles, the name by which a company in existence has been previously registered, will be deemed to be undesirable.

The Registrar must make preliminary enquiries to ensure that the name allowed by him is not misleading or intended to deceive with reference to the Objects Clause of the memorandum [Methodist Church v. Union of India, (1985) 57 Com Cases 443 (Bombay)].

The Registrar is not, however, required to carry out any elaborate investigation at the time of registration of the company. Unless the purpose of the company appears to be unlawful ex-facie or is transparently illegal or prohibited by any statute, it cannot be regarded as an unlawful association [T.V. Krishna v. Andhra Prabha (P) Ltd., (1960) 30 Com Cases 437 (AP)].

The objective is to prevent the use of a name which is likely to mislead the public. For example, a company is not allowed to use a name which is prohibited under the Emblems and Names (Prevention of Improper Use) Act, 1950, or suggestive of any connection with Government or of State patronage where there is none.

Caselet

Thus, in Ewing v. Buttercup Margarine Co. Ltd. (1917) 2 Ch. 1, the plaintiff, who carried on business under the name of the Buttercup Dairy Co., obtained an injunction against the defendant (Buttercup Margarine Co. Ltd.), on the grounds that the public might think that the two businesses were connected, the word "Buttercup" being a fancy one.

The rule will apply also to foreign companies or traders, whose goods are imported into the country, as it was applied in the case of La Societe Anonyme Panchard at Levessor v. Panchard Levessor Motor Co. Ltd., (1901) 2 Ch. 513. The plaintiffs were a French company carrying on business in Paris as motor car manufacturers and were using the name "Panchard" in connection with motors of their manufacture.

They objected to the use of the word "Panchard" in the name of the defendant company on the ground that the principal object of the defendants was to injure wrongfully and fraudulently the plaintiffs' business by passing off their goods as those of the plaintiffs' manufacture and succeed even though they had no agencies in England but had a market for their goods there.

Section 16 provides that if by inadvertence or otherwise a name has been registered which is identical to or too nearly resembles the name of an existing company whether registered under this Act or the previous company law, the Central Government may direct the company to change its name.

The company shall change its name within a period of 3 months from the issue of the above direction after passing an ordinary resolution for the purpose. The Central Government is empowered to direct a company, at any point of time to rectify its name if by inadvertence it has been registered with a name similar to that of an existing company.

If a company is so directed by the Central Government, it must change the name within 3 months of the direction after passing an ordinary resolution. This section also gives enhanced power to the Central Government to order rectification of name where such name in its opinion constitutes an infringement of a registered trademark.

The proprietor of the registered trade mark may make an application to the Central Government for an order for rectification of name because it is identical to or too nearly resembles the applicant's registered trademarks. Such application must be made within three years from the date of incorporation or the registration or change of name whether under this Act or previous company law.

In such a case the Central Government may direct the company to change its name and the company shall change its name, within a period of six months from the issue of such direction, after passing an ordinary resolution for the purpose.

Where a company changes its name or obtains a new name, it shall within a period of fifteen days from the date of such change, give notice of the change to the Registrar along with the order of the Central Government, who shall carry out necessary changes in the certificate of incorporation and the memorandum.

Caselet

In the case of Atlas Cycles (Haryana) Ltd. v. Atlas Products Pvt. Ltd [146 (2008) DLT 274 (DB)], use of the brand name as corporate name was settled. Both the plaintiff and the defendant companies belong to the same family. The Appellant-plaintiff was the proprietor of the trade mark in the name "Atlas". The Respondent-defendant company containing the name "Atlas" in its corporate name started dealing in bicycles. The plaintiff objected to the use of the name "Atlas" by the defendant company. The Defendants were restrained from using the word "Atlas" in their corporate/trade name in respect of bicycles and bicycle parts.

Where a company is directed to change the name, the court cannot directly tell the Registrar to effect the change in the name of the company. The Court can only direct the company to do so. The company cannot simply file the Court order regarding the change but it will have to follow the prescribed procedure [*Halifax Plc v. Halifax Repossessions Ltd (2004) 2 BCLC 455 (CA)*].

But mere similarity of name is not in itself enough to give a right to an injunction. As held in D.W. Boulay v. D.W. Boulay, (1868) LR 2 (PC), the law does not gives a person the right to prevent the use of a name by another person. In the case of companies, however, registration will be refused only if there is likelihood of deception or confusion.

A person cannot be permitted to name a company even after his personal name if that name resembles the name of an existing company [*K.G. Khosla Compressors Ltd. v. Khosla Extractions Ltd., (1986) 1 Comp LJ 211 : AIR 1986 Del 181*]. In the case of incorporation of an Asset Management Company (AMC), the Memorandum and Articles of Association are required to be vetted and approved by the Securities and Exchange Board of India (SEBI) before these documents are registered by the Registrar of Companies.

Too Similar Name

In case of too similar names, the resemblance between the two names must be such as to be calculated to deceive. A name shall be said to be calculated to deceive where it suggests some connection or association with the existing company.

Examples:

(i) In Society of Motor Manufacturers and Traders Ltd. v. Motor Manufacturers and Traders Mutual Assurance Ltd. (1925) 1 Ch. 675, the plaintiff company brought an action to restrain the defendant company to use the said name. But, Lawrence, J., held "anyone who took the trouble to think about the matter, would see the defendant company which was an insurance company and that the plaintiff society was a trade protection society and I 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".

(ii) In Asiatic Govt. Security Life Insurance Co. Ltd. v. New Asiatic Insurance Co. Ltd. (1939) 9 Comp. Cas. 208, the court held the two names were not too identical and therefore did not restrain from using their name.

(iii) In Ervind v. Buttercup Margarine Co. Ltd. (1917), the plaintiff who carried on business under the name of the Buttercup Dairy Co. succeeded in obtaining an injunction against the defendant on the ground that the public might think that the two businesses were connected, since the word 'buttercup' was an unnecessary and fancy one.

(iv) In Executive Board of the Methodist Church in India v. Union of India (1985) 57 Comp. Cas. 443 (Bom), the Methodist Church in India sought registration of a company in the name of 'Methodist Church in India Trust Association'. There was already an existing company bearing the name 'Methodist Church in Northern India Trust Association (P) Ltd.' in Calcutta.

The former secretary of the later's association informed the Registrar that the said company had not functioned since 1970; that no annual reports or minutes had been filed with the Registrar since 1970; and that some directors had died and some had left.

The question was whether in these circumstances the Calcutta company was a bar to the registration of the new company.

Held: if a company is practically defunct, it is not a bar to the registration of a new company with a similar name.

Use of certain key words as part of the name

The Department of Company Affairs has clarified that if a company used any of the following keywords in its name, it must have a minimum authorised capital mentioned against the keywords:

Keywords	Required Authorised Capital (₹)
(i) Corporation	5 crores
(ii) International, Globe, Universal Continental, Inter-continental, Asiatic, Asia, being the first word of the name.	1 crore
(iii) If any of the words at (ii) above is used within the name (with or without brackets).	50 lakhs
(iv) Hindustan, India, Bharat, being the first word of the name.	50 lakhs
(v) If any of the words at (iv) above is used within the name (with or without brackets).	5 lakh
(vi) Industries/Udyog.	1 crore
(vii) Enterprises, Products, Business, Manufacturing.	10 lakhs

Publication of name Section (147)

Every company shall: (a) paint or affix its name and the address of its registered office and keep the same painted or affixed, on the outside of every office or place of business in a conspicuous position in letters easily legible and in the language in general use in the locality.

Department of Company Affairs has clarified that exhibition of its name in English alone, without at the same time showing it in the local language will not be sufficient compliance with the requirements of the Section.

The words 'outside of every office' do not mean outside the premises in which the office is situated [Dr. H.L. Batliwala Sons & Co. Ltd. v Emperor (1941) 11 Comp.

Cas. 154 (Bom)]. Where office is situated within a compound, the display outside the office room though inside the building is sufficient.

(b) have its name engraved in legible characters on its seal.

(c) have its name and address of its registered office mentioned in legible characters in all business letters, bill heads, negotiable instruments, invoices, receipts, etc., of the company.

Further in case of One Person Company, the words "One Person Company" shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved. Ministry of Corporate Affairs (MCA) has clarified that display of its name in English in addition to the display in the local language will be a sufficient compliance with the requirements of the section.

The MCA has also clarified that a share certificate is not an official publication of a company within the meaning of Section 147 of the Act [Corresponds to section 12 of the Companies Act, 2013] [Circular No. 3/73/8/10(147)/ 72-CC-V dated 3.2.1973]. The words 'outside of every office' do not mean outside the premises in which the office is situated [Dr. H.L. Batliwalla Sons & Company Ltd. v. Emperor (1941) 11 Com Cases 154: AIR 1941 (Bom.) 97]. Where office is situated within a compound, the display outside the office room, though inside the building, is sufficient.

Penalty

If a company does not paint or affix its name and the address of its registered office in the prescribed manner, the company and every officer of the company who is in default shall be punishable with fine.

Also, every officer of a company or any person on its behalf who signs or authorises to be signed on behalf of the company any bill of exchange, hundi, promissory note or cheque, etc., wherein the name of the company is not mentioned in the prescribed manner, shall be personally liable to the holder of such bills of exchange, hundi, promissory note, cheque, etc., for the amount thereof unless it is paid the company. Personal Liability will, however, be not incurred in the following cases:

(a) The holder of a negotiable instrument, on which the company's name has been incorrectly stated, will not be able to enforce the personal liability under Section 147(4) against the officer concerned if the error was due to the holder's own act [Durham Fancy Goods Ltd. v. Michael Jackson (Fancy Goods) Ltd. and Another (1968) 2 Q.B. 839].

(b) The word 'Limited' is abbreviated to 'Ltd.' (P. Stacey & Co. v. Wallis (1912) 28 T.L.R. 219.

(c) There is an accidental omission of the word 'limited' [Dermatine Co. v. Ashworth (1905) 21 T.L.R. 510]. In this case, a bill of exchange was accepted on behalf of a limited company. The rubber stamp of the company was longer than the paper.

As a result, the word 'limited' did not appear on the instrument. Held, the directors who accepted the bill of exchange were not personally liable because omission was neither deliberate nor of negligent in origin. It was an obvious error of most trifling kind and the mischief aimed at by the Act did not here exist.

3.4 THE REGISTERED OFFICE CLAUSE OR SITUATION CLAUSE [SECTION 13(1)(B)]

This clause states the name of the State in which the registered office of the company will be situated. Every company must have registered office which establishes its

domicile and it is also the address at which company's statutory books must normally be kept and to which notices and all other communications can be sent. The notice of the exact situation (address) of the registered office may be given to the Registrar within thirty days from the date of incorporation (Section 146).

As in the case of publication of the company's name, section 147 also makes similar provisions regarding publication of the Registered Office of the company.

Section 12(3) states that every company shall:

(a) Paint or affix its name, and the address of its registered office, and keep the same painted or affixed, on the outside of every office or place in which its business is carried on, in a conspicuous position, in legible letters, and if the characters employed therefore are not those of the language or of one of the languages in general use in that locality, also in the characters of that language or of one of those languages;

(b) Have its name engraved in legible characters on its seal;

(c) Get its name, address of its registered office and the Corporate Identity Number along with telephone number, fax number, if any, e-mail and website addresses, if any, printed in all its business letters, billheads, letter papers and in all its notices and other official publications; and

(d) Have its name printed on hundies, promissory notes, bills of exchange and such other documents as may be prescribed: Provided that where a company has changed its name or names during the last two years, it shall paint or affix or print, as the case may be, along with its name, the former name or names so changed during the last two years as required under clauses (a) and (c).

3.5 THE OBJECTS CLAUSE [SECTION 13(1)(D)]

Under section 4(1)(c) of the Companies Act, 2013, all companies must state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof. The objects clause defines the objects of the company and indicates the sphere of it activities. A company cannot do anything beyond or outside its objects and any act done beyond them will be ultra vires and void and cannot be ratified even by the assent of the whole body of shareholders.

However, a company may do anything which is incidental to and consequential upon the objects specified and such act will not be ultra vires. The objects clause is of great importance because it determines the purpose and the capacity of the company. It indicates the purpose for which the company has been set up and its actual capability, besides its sphere of activities. Thus, a trading company has an implied power to borrow money, draw and accept bills of exchange.

Section 13, read along with Tables 'B', 'C', 'D' and 'E', requires the company to divide its objects clause into three parts: (a) Main objects of the company to be pursued by the company on its incorporation; (b) Objects incidental or ancillary to the attainment of the main objects; and (c) Other objects of the company not included in (a) and (b) above. The subscribers to the memorandum of association enjoy almost unrestricted freedom to choose the objects. The only restriction is that objects should not be illegal and against the provisions of the Companies Act, 2013.

A company may on receipt of certificate to commence business, pursue any business given in the 'main objects'. In the case of companies (other than trading companies) with objects not confined to one State, the Memorandum must give the name of the State/(s) to whose 'territories the objects extend'.

No business given in 'other objects' can, however, be commenced unless prior approval of shareholders with regard thereto is obtained by way of special resolution passed in general meeting [Section 149(2A)]. Where special resolution is not passed, the Central Government, may on an application made by the Board of directors, allow a company to commence business in the 'other objects', provided the votes cast in favour of the resolution exceed the votes cast against the resolution, if any [Section 149(2B)].

The objects of the company must not be illegal, immoral or opposed to public policy or in contravention of the Act. For example, Section 77 prohibits a company to purchase its own shares.

It is ultra vires for a company to act beyond the limits of its memorandum. Any attempted departure will be invalid and cannot be validated even if assented to by all the shareholders of the company. Ultra vires means an act or transaction of a company, which though it may not be illegal, is beyond the company's powers by reason of not being within the objects of the memorandum of association.

The memorandum is, so to speak, the limit beyond which a company cannot travel [*Ashbury Railway Carriage and Iron Company v. Riche, (1875) LR 7 HL 653*]. The Memorandum of Association is the 'Lakshman Rekha' for a company. An act beyond the objects mentioned in the memorandum is ultra vires and void and cannot be ratified [*Dr. Lakshmanaswami Mudaliar A v LIC (1963) Comp LJ 248: 1963 33 Com Cases 420: AIR 1963 SC 1185*].

Where no connection or nexus exists between the exercise of a power and the attainment of an object, exercise of power will be ultra vires [Radha Cinema & Co. v. Chitralipi Films, 1974 Tax LR 2180 (Cal)].

Doctrine of Ultra Vires

In the case of a company whatever is not stated in the memorandum as the objects or powers is prohibited by the doctrine of ultra vires. As a result, an act which is ultra vires is void, and does not bind the company. Neither the company nor the contracting party can sue on it.

Also, as stated earlier, the company cannot make it valid, even if every member assents to it. The general rule is that an act which is ultra vires the company is incapable of ratification. An act which is intra vires the company but outside the authority of the directors may be ratified by the company in proper form [Rajendra Nath Dutta v. Shilendra Nath Mukherjee, (1982) 52 Com Cases 293 (Cal.)].

The rule is meant to protect shareholders and the creditors of the company. If the act is ultra vires (beyond the powers of) the directors only, the shareholders can ratify it. If it is ultra vires the articles of association, the company can alter its articles in the proper way.

The memorandum of the company in the said case defined its objects thus: "The objects for which the company is established are to make and sell, or lend or hire, railway plants..... to carry on the business of mechanical engineers and general contractors.....".

The company entered into a contract with M/s. Riche, a firm of railway contractors to finance the construction of a railway line in Belgium.

On subsequent repudiation of this contract by the company on the ground of its being ultra vires, Riche brought a case for damages on the ground of breach of contract, as according to him the words "general contractors" in the objects clause gave power to the company to enter into such a contract and, therefore, it was within the powers of the company.

More so because the contract was ratified by a majority of shareholders. The House of Lords held that the contract was ultra vires the company and, therefore, null and void. The term "general contractor" was interpreted to indicate as the making generally of such contracts as is connected with the business of mechanical engineers.

The Court held that if every shareholder of the company had been in the room and had said, "That is a contract which we desire to make, which we authorise the directors to make", still it would be ultra vires. The shareholders cannot ratify such a contract, as the contract was ultra vires the objects clause, which by Act of Parliament, they were prohibited from doing.

However, later on, the House of Lords held in other cases that the doctrine of ultra vires should be applied reasonably and unless it is expressly prohibited, a company may do an act which is necessary for or incidental to the attainment of its objects. Section 13(1)(d) of the Companies Act, 1956 [Corresponds to Section 4(1)(c) of the Companies Act, 2013] provides that the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof be stated in the memorandum.

However, even when the matters considered necessary in furtherance of the objects are not stated, they would be allowed by the principle of reasonable construction of the memorandum.

Caselet

Justice Shah (afterwards C.J.) in the case A. Lakshmanaswami Mudaliar v. L.I.C., A.I.R. 1963 S.C. 1185. upheld the doctrine of ultra vires. In this case, the directors of the company were authorised "to make payments towards any charitable or any benevolent object or for any general public or useful object". In accordance with shareholders' resolution the directors paid ₹ 2 lacs to a trust formed for the purpose of promoting technical and business knowledge. The company's business having been taken over by L.I.C., it had no business left of its own.

The Supreme Court held that the payment was ultra vires the company. Directors could not spend company's money on any charitable or general objects.

They could spend for the promotion of only such charitable objects as would be useful for the attainment of the company's own objects. It is pertinent to add that the powers vested in the Board of Directors, e.g., power to borrow money, is not an object of the company. The powers must be exercised to promote the company's objects.

Charity is allowed only to the extent to which it is necessary in the reasonable management of the affairs of the company. Justice Shah held: "There must be proximate connection between the gift and the company's business interest".

Thus "gifts to foster research relevant to the company's activities" and "payments to widows of ex-employees on the footing that such payments encourage persons to enter the employment of the company" have been upheld as valid and intra vires. A bank or any other person lending to a company, for purposes ultra vires the memorandum, cannot recover [National Provincial Bank v. Introductions Ltd., (1969) 1 All. E.R. 887].

Further, in the case of Bell Houses Ltd. v. City Wall Properties Limited (1966) 36 Com Cases 779, the objects clause included 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". The Court has held the same to be in order.

3.6 LIABILITY CLAUSE [SECTION 13(2)]

This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee. This means that in case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares held by him. In case of companies limited by guarantee, this clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its winding up.

In the case of an unlimited company, this clause needs not be given in the memorandum. In fact, the absence of this clause in the memorandum means that the liability of its members is unlimited.

As per Section 45, under certain circumstances the liability of members of a limited company becomes unlimited.

3.7 THE CAPITAL CLAUSE [SECTION 13(4)(C)]

This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share. The shares into which the capital is divided must be of fixed value, which is commonly known as the nominal value of the share. The capital is variously described as "nominal", "authorised" or "registered".

The amount of nominal capital is determined having regard to the present as well as future requirements of the company with reference to its objects. The usual way to state the capital in the memorandum is: "The capital of the company is ₹10,00,000 divided into 1,00,000 equity shares of ₹10 each". This amount lays down the maximum limit beyond which the company cannot issue shares without altering the memorandum as provided by Section 61 of the Companies Act, 2013.

If there are both equity and preference shares, then the division of the capital is to be shown under these two heads. A company is not authorised to issue capital beyond its authorised/nominal/registered capital. If it receives applications for shares beyond the shares covered by the authorised capital, the amount received on excess number of shares should be returned.

Out of the issued capital, the total amount actually subscribed or agreed to be subscribed is known as subscribed capital, and this subscribed capital again may be wholly paid or partly paid, in which latter case the balance would be payable on future calls when made.

The amount actually paid by the shareholders is called the paid-up capital. According to Section 60 of the Act, if the amount of the authorised capital (nominal capital), of the company is stated in any notice, advertisement, official publication, business letter, hill head or letter paper, it shall also contain a statement in an equally prominent position and in equally conspicuous terms the amount of capital which has been subscribed and the amount paid-up.

3.8 THE ASSOCIATION CLAUSE [SECTION 13(4)(C)]

At the end of the memorandum of every company there is an association or subscription clause or a declaration of association which reads something like this:

"We, the several persons whose names and addresses and occupations are subscribed, 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".

Then follow the names, addresses, descriptions, occupations of the subscribers and the number of shares each subscriber has taken and his signature attested by a witness.

3.9 SIGNING OF MEMORANDUM

Rule 13 Companies (Incorporation) Rules, 2014

The Memorandum and Articles of Association of the company shall be signed in the following manner, namely:

1. The memorandum and articles of association of the company shall be signed by each subscriber to the memorandum, who shall add his name, address, description and occupation, if any, in the presence of atleast one witness who shall attest the signature and shall likewise sign and add his name, address, description and occupation, if any and the witness shall state that "I witness to subscriber/subscriber(s), who has/have subscribed and signed in my presence (date and place to be given); further I have verified his or their Identity Details (ID) for their identification and satisfied myself of his/her/their identification particulars as filled in".
2. Where a subscriber to the memorandum is illiterate, he shall affix his thumb impression or mark which shall be described as such by the person, writing for him, who shall place the name of the subscriber against or below the mark and authenticate it by his own signature and he shall also write against the name of the subscriber, the number of shares taken by him.
3. Such person shall also read and explain the contents of the memorandum and articles of association to the subscriber and make an endorsement to that effect on the memorandum and articles of association.
4. Where the subscriber to the memorandum is a body corporate, the memorandum and articles of association shall be signed by director, officer or employee of the body corporate duly authorized on this behalf by a resolution of the Board of Directors of the body corporate and where the subscriber is a Limited Liability Partnership, it shall be signed by a partner of the Limited Liability Partnership, duly authorized by a resolution approved by all the partners of the Limited Liability Partnership: Provided that in either case, the person so authorized shall not, at the same time, be a subscriber to the memorandum and articles of Association.
5. Where subscriber to the memorandum is a foreign national residing outside India-
   (a) In a country in any part of the Commonwealth, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized by a Notary (Public) in that part of the Commonwealth.
   (b) In a country which is a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity shall be notarized before the Notary (Public) of the country of his origin and be duly apostilled in accordance with the said Hague Convention.
   (c) In a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his signatures and address on the memorandum and articles of association and proof of identity, shall be notarized before the Notary (Public) of such country and the certificate of the Notary (Public) shall

be authenticated by a Diplomatic or Consular Officer empowered in this behalf under section 3 of the Diplomatic and Consular Officers [(Oaths and Fees) Act, 1948 (40 of 1948)] or, where there is no such officer by any of the officials mentioned in section 6 of the Commissioners of Oaths Act, 1889 (52 and 53 Vic.C.10), or in any Act amending the same.

(d) Visited in India and intended to incorporate a company, in such case the incorporation shall be allowed if, he/she is having a valid Business Visa. **Explanation**– For the purposes of this clause, it is hereby clarified that, in case of Person is of Indian Origin or Overseas Citizen of India, requirement of business Visa shall not be applicable.

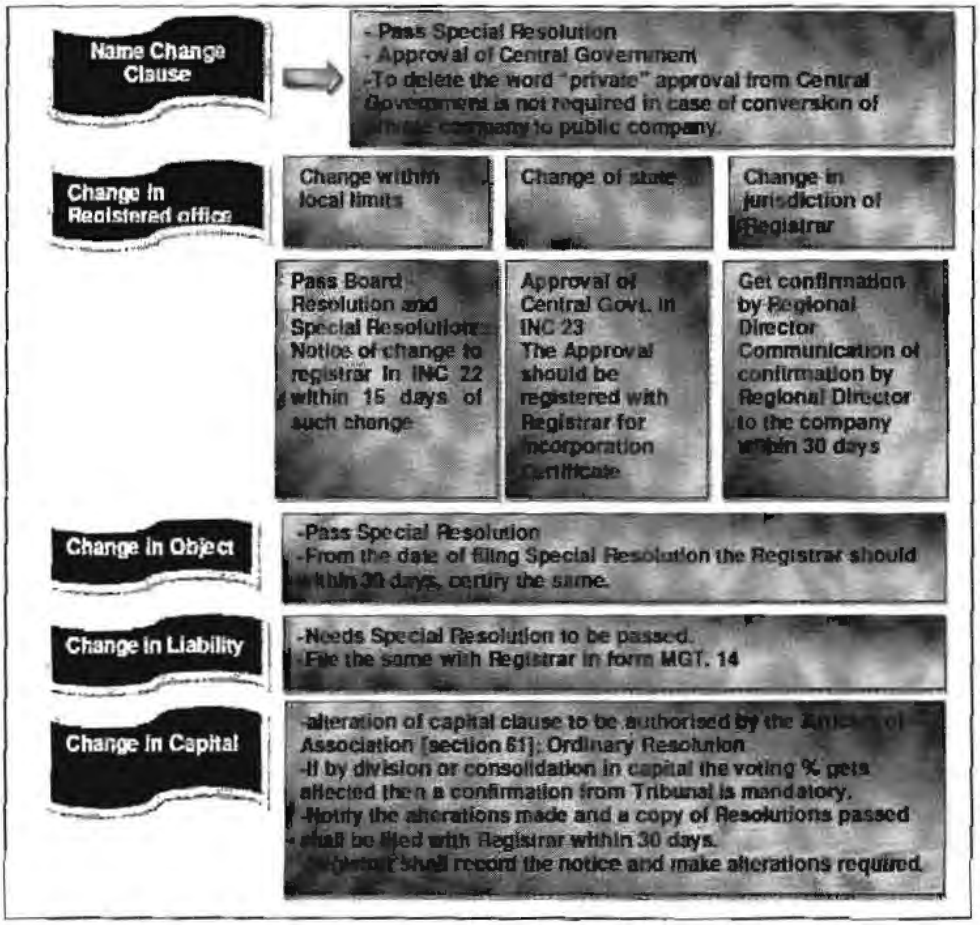
Subscription Induced by Misrepresentation

A subscriber to the memorandum cannot, after the issue of the certificate of incorporation, repudiate his subscription on the ground that he was induced to sign by misrepresentation [Re Metal Constituents Ltd., Lord Lurgan's case – Re, (1902) 1 Ch 707].

3.10 ALTERATION OF MEMORANDUM OF ASSOCIATION

Section 16 provides that the company cannot alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provision has been made in the Act. These provisions are explained herein below:

ALTERATION OF MEMORANDUM OF ASSOCIATION



Change of Name. Section 21 provides that the name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government. However, no approval of the Central Government is necessary if the change of the name involves only the addition or deletion of the word 'private' (i.e., when public company is converted into a private company or vice versa).

If through inadvertence or otherwise, a company has been registered with a name which is identical with or too closely resembles with the name of an existing company, the company may change its name by passing an ordinary resolution and by obtaining the approval of the Central Government in writing (Section 22).

The change of name must be communicated to the Registrar of Companies within 30 days of the change. The Registrar shall then enter the new name on the register in the place of the old name and shall issue a fresh certificate of incorporation with necessary alterations [Section 23(1)]. The change of name becomes effective on the issue of fresh certificate of incorporation. The Registrar will also make the necessary alteration in the memorandum of association of the company [Section 23(2)].

However, change of name shall not affect any rights or obligations of the company or render defective any legal proceeding 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 new name [Section 23(3)].

Within 30 days of the passing of the special resolution, a printed or a type written copy of the resolution should be sent to the Registrar of Companies.

Change of registered office. The procedure depends on whether the change is within the jurisdiction of same registrar of companies (Section 146) or whether the shifting is to the jurisdiction of another registrar of companies in the same state (Section 146 and Section 17A). This may include:

(a) *Change of registered office from one premises to another premises in the same city, town or village.* The company may do so anytime. A resolution passed by the Board of Directors shall be sufficient. However, notice of the change should, within 30 days after the date of the change, be given to the Registrar who shall record the same (Section 146).

(b) ***Change of registered office from one town or city or village to anather town or city or village in the same State (Section 146).*** In this case, the procedure is:

  (i) a special resolution is required to be passed at a general meeting of the shareholders;

  (ii) a copy of it is to be filed with the Registrar within 30 days;

  (iii) within 30 days of the removal of the registered office, notice of the new location has to be given to the Registrar who shall record the same.

(c) *Shifting of the registered office from one place to another within the same state (Section 17A).* The shifting of the registered office by a company from the jurisdiction of one registrar of companies to the jurisdiction of another registrar of companies within the same state shall (in addition to requirements under Section 146) also require confirmation by the Regional Director. For this purpose, an application is to be made in the prescribed form and the confirmation shall be communicated within four weeks. Such confirmation is required to be field within two months with the registrar of companies who shall register and certify the same within one month. Such certificate shall be conclusive evidence of the compliance of all requirements under the Act.

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

Section 17 provides for the shift of the registered office from one State to another and such shift involves alteration of memorandum. The change of registered office from one locality to another in the same city or from one city to another in the same state does not involve alteration of memorandum.

The shift of the registered office from one state to another can be done by a special resolution which is required to be confirmed by the Central Government.

The Central Government, before confirming the resolution, will satisfy itself that sufficient notice has been given to every creditor and all other persons whose interests are likely to be affected by the alteration, including the Registrar of Companies and the Government of the state in which the registered office is situated.

Also, the Central Government will give an opportunity to members and creditors of the company, the Registrar and other persons interested in the company to be heard. The Central Government may confirm the resolution on such terms and conditions as it thinks fit.

It was made clear in Zuari Agro Chemicals Ltd. v. F. S. Wadia and Others (1974) 44 Comp. Cas. 465 that the Company Law Board (now Central government) will not substitute its own wisdom or judgement for the collective wisdom or judgement of the company expressed in special resolution. But the bonafides of the company's application for change can be screened.

Loss of revenues of state, whether relevant consideration. In Orient Paper Mills Ltd. v. State, AIR (1957) Ori. 232 it was observed that a State whose interests are affected by the change has a locus standi to oppose shift of registered office of a company.

Accordingly, the Orissa High court declined to confirm change of registered office from Orissa to West Bengal, inter alia, on the ground that in a Federal constitution every State has the right to protect its revenue and, therefore, the interest of the State must be taken into account.

But in Minerva Mills Ltd. v. Govt. of Maharashtra (1975) 45 Comp. Cas 1(Bom.), Justice Ray of the Bombay High Court held that the Company Law Board (now Central government) cannot refuse confirmation on the ground that the change would cause loss of revenue to a State or would have adverse effects on the general economics of the State.

The question of loss of revenue to one State would have to be considered in the prospectus of total revenues for the Republic of India and no parochial considerations should be allowed to turn the scale in regards to change of registered office from one State to another within India.

Similar view was expressed in Rank Film Distributors of India Ltd. v. Registrar of Companies, West Bengal [AIR (1969) Cal. 32], i.e., that State has no statutory right under Section 17 to oppose the shifting of the registered office from one State to another.

A printed or a typewritten copy of the special resolution both under Section 146 and Section 17 should be sent to the Registrar within 30 days of its passing.

A certified copy of the Central Government order of the Central Government should be filed within three months thereof with the Registrar of each State – the old and the new State. If it is not filed within the prescribed time, then the alteration shall, at the expiry of such period, becomes void and inoperative.

A notice of the new location of the registered office must be given to the Registrar of the State to which the office has been shifted, within thirty days after the change of the office (Section 146).A company is in a position to shift its registered office from one

State to another for certain purposes only. These are discussed in the following paragraph (under 'Alteration of objects' – the grounds being common).

Alteration of objects clause. Section 17 empowers a company by a special resolution to alter the objects or to change the place of its registered office from one State to another if the alteration is sought on any of the following grounds.

1. ***To carry on its business more economically and more efficiently.*** In Dalmia Cement (Bharat) Ltd., In re (1964) 34 Comp. Cas. 729 (Mad.), the Court observed that whether a company can carry on its business more economically or more efficiently is a matter of judgement for the directors.

   If the directors consider that under the existing circumstances, it will be convenient and advantageous to combine the new objects with the existing objects and if it appears that such a conclusion may be fairly arrived at, the Court (now Central government) will not go behind it and hold an enquiry as to whether the opinion of the directors is well founded or is justified.

   The true legal position, observed the Delhi High Court, is that the business must remain substantially the same and the additions, alterations and changes should only be steps-in-aid to improve the efficiency of the company [Delhi Bharat Grain Merchants Assn. Ltd., In re (1974) 44 comp. Cas. 214 (Delhi)].

   In Re, Scientific Poultry Breeders Association (1933) 3 Comp. Cas. 89 (CA), a company's memorandum prohibited payment of remuneration to the members of its governing body. It wanted for efficient management, amendment in the memorandum to enable it to pay remuneration to its governing body members which was allowed.

2. ***To attain its main purpose by new or improved means.*** For the companies registered after 10th October, 1965, there is no difficulty in ascertaining the main purpose because the Memorandum would state it. But for the companies registered earlier, one has to look not only to the memorandum but also to what has actually been done.

3. ***To enlarge or change the local area of its operation.*** In India Mechanical Gold Extracting Company, In Re (1891) 3 Ch. 538, the company's business was confined to the 'Empire of India'. It wanted to enlarge its operations by dropping these words. It was allowed to do so on the condition that the word 'Indian' was also dropped from its name.

4. ***To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company.*** In fact, most of the amendments sought in objects clause are based on this ground. This clause enables a company to diversify. The working of the clause makes its scope very wide in as much as any activity which may either conveniently or advantageously be combined with the existing business may be allowed.

5. ***To restrict or abandon any of the objects specified in the memorandum.*** Even for deleting any portion of the object clause, the procedure laid down in Section 17 has to be followed.

6. ***To sell or dispose of the whole or any part of the undertaking.*** Where a company wishes to adopt a cut-back or retrenchment strategy, i.e., where it feels that it has either grown too big or diversified in various directions that managing becomes difficult or uneconomical, it may alter its objects to sell or dispose of any of its undertakings.

7. ***To amalgamate with any other company or body of persons.*** A printed or a typewritten copy of the special resolution is required to be filed with the Registrar within thirty days of the passing thereof.

   Also a petition is to be filed with the Central Government for confirmation of the special resolution. The Central Government, being satisfied that the notice of the resolution was given to all persons whose interests are likely to be affected by the alteration, including the Registrar and the State Government and having heard them, may confirm the alteration either wholly or in part.

   A certified copy of the order of the Central Government together with a printed copy of the altered memorandum must be filed within three months of the date of the order, with the Registrar. The Registrar will register the documents and issue, within one month a certificate which will be conclusive evidence that everything required has been done (Section 18). If the required documents are not filed within the prescribed time, the alteration and the order of the Central Government confirming the alteration, shall, at the expiry of such period, become void and inoperative (Section 19).

Alteration of liability clause (Section 38). The liability of a member of a company cannot be increased unless the member agrees in writing. The consent of the member may, however, be given either before or after the alteration. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

In case where the company is a club or any other similar association and the alteration in the memorandum requires the member to pay recurring or periodical subscription or charges at a higher rate, although he does not agree in writing to be bound by the alteration, it shall be binding on him.

In case of unlimited liability company, the liability may be made limited. The alteration will, however, not affect any debts, liabilities, obligations or contracts entered into by or with the company before the conversion.

Alteration of capital clause. Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as:

1. to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
2. to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
3. to convert all or any of its fully paid-up shares into stock and reconvert the stock into fully paid-up shares of any denomination;
4. to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same;
5. to cancel the shares which at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person.

Check Your Progress

Fill in the blanks.

1. The _____is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built.
2. In case of_____, the words shall be mentioned in brackets below the name of such company, wherever its name is printed, affixed or engraved.
3. Every company must have _____which establishes its domicile and it is also the address at which company's statutory books must normally be kept.
4. A company cannot do anything beyond or outside its _____and any act done beyond them will be ultra vires and void and cannot be ratified even by the assent of the whole body of shareholders.
5. _____ states the nature of liability of the members. In case of a company with_____, it must state that liability of members is limited, whether it be by shares or by guarantee.

3.11 LET US SUM UP

- The memorandum of association contains the name, situation of registered office, objects, capital and liability clauses.
- Section 4(6) of the Companies Act, 2013 provides that the memorandum of association should be in any one of the Forms specified in Tables A, B, C, D or E of Schedule I to the Act, as may be applicable in the case of the company or in Forms as near thereto as circumstances admit.
- The Department of Company Affairs has issued guidelines for deciding availability of names.
- In case of too similar names, the resemblance between the two names must be such as to be calculated to deceive. A name shall be said to be calculated to deceive where it suggests some connection or association with the existing company.
- Every company must have registered office which establishes its domicile and it is also the address at which company's statutory books must normally be kept and to which notices and all other communications can be sent.
- Under section 4(1)(c) of the Companies Act, 2013, all companies must state in their memorandum the objects for which the company is proposed to be incorporated and any matter considered necessary in furtherance thereof.
- In the case of a company whatever is not stated in the memorandum as the objects or powers is prohibited by the doctrine of ultra vires. As a result, an act which is ultra vires is void, and does not bind the company.
- In case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee.
- The shares into which the capital is divided must be of fixed value, which is commonly known as the nominal value of the share. The capital is variously described as "nominal", "authorised" or "registered".

3.12 LESSON END ACTIVITY

A company was incorporated with the purpose of manufacturing chemicals. Later the company proposed to alter the objects clause in its Memorandum of Association in order to be able to invest in the encouragement of scientific education. Is the alteration legally permissible? Explain in detail.

3.13 KEYWORDS

Memorandum of Association: The Memorandum of Association is a document which sets out the constitution of a company and is therefore the foundation on which the structure of the company is built.

Registered Office Clause: This clause states the name of the State in which the registered office of the company will be situated.

Liability clause: This means that in case of a company limited by shares, a member can be called upon at any time to pay to the company the amount unpaid on the shares held by him.

Capital clause: This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share.

Ultra Vires: The Company's activities are confined strictly to the objects mentioned in its memorandum and if they are beyond these objects, then such acts are known as 'ultra vires'.

Doctrine of Constructive Notice: This doctrine enunciates that any person dealing with the company is presumed to have read its memorandum and articles.

3.14 QUESTIONS FOR DISCUSSION

1. Define memorandum of association. What does it contain?
2. How are alterations made in a memorandum of association?
3. What are the compulsory clauses of memorandum?
4. Discuss the provision of law with regard to name clause of memorandum. Also give example.
5. Why it is necessary to have registered office? State the legal requirement.
6. Discuss about the publication of name.

Check Your Progress: Model Answer

1. Memorandum of Association
2. One Person Company
3. Registered office
4. Objects
5. Liability clause, limited liability

3.15 SUGGESTED READINGS

S.S Gulshan. *Business Law*. Third Edition, 2006, Excel Books, New Delhi.

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LESSON

4

ARTICLES OF ASSOCIATION AND PROSPECTUS

CONTENTS

Contd .

4.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Discuss the nature of articles, articles subordinate to memorandum and articles in relation to memorandum
- Explain the registration of articles
- Discuss the entrenchment provisions
- State the statutory requirements of articles
- Identify the provision in articles as regards to expulsion of a member
- Explain the alteration of articles
- Know the limitations on power to alter articles
- Identify the effect of memorandum and articles/binding force of memorandum and articles
- Elucidate the doctrine of indoor management
- Identify the distinction between memorandum and articles
- Discuss the prospectus and steps which are necessary before the issue of prospectus

4.1 INTRODUCTION

The articles of association of a company and its bye-laws are regulations which govern the management of its internal affairs and the conduct of its business. They define the duties, rights, powers and authority of the shareholders and the directors in their respective capacities and of the company and the mode and form in which the business of the company is to be carried out.

The Articles of Association of a company have a contractual force between company and its members as also between the members inter se in relation to their rights as such members. They are subordinate to and are controlled by memorandum. Articles cannot supersede the objects as set out in the Memorandum of Association.

The memorandum, as we have seen earlier, lays down the scope and powers of the company, whereas the articles govern the ways in which the objects of the company are to be carried out. Also the alteration of memorandum involves elaborate procedure, whereas the articles can be framed and altered by the members by passing special resolution.

The memorandum is the area beyond which the actions of the company cannot go inside that area the shareholders may make such regulations for their own governance as they think fit. However, the articles must not be inconsistent with the memorandum. Also, as in the case of memorandum, the articles of the company must not contain anything which is against or repugnant to the provisions of the Companies Act (Section 9).

4.2 NATURE OF ARTICLES

According to Section 2(5) of the Companies Act, 2013, 'articles' means the articles of association of a company as originally framed or as altered from time to time or applied in pursuance of any previous company law or of this Act.

It also includes the regulations contained in Table A in Schedule I of the Act, in so far as they apply to the company. In terms of Section 5(1), the articles of a company shall contain the regulations for management of the company. The articles of association of a company are its bye-laws or rules and regulations that govern the management of its internal affairs and the conduct of its business.

The articles play a very important role in the affairs of a company. It deals with the rights of the members of the company inter se. They are subordinate to and are controlled by the memorandum of association. The general functions of the articles have been aptly summed up by Lord Cairns, L.C. in Ashbury Railway Carriage and Iron Co. Ltd. v. Riche, (1875) L.R. 7 H.L. 653 as follows:

"The articles play a part that is subsidiary to the memorandum of association. They accept the memorandum of association as the charter of incorporation of the company, and so accepting it, the articles proceed to define the duties, rights and powers of the governing body as between themselves and the company at large, and the mode and form in which business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made... The memorandum, is as it were... the area beyond which the action of the company cannot go; inside that area shareholders may make such regulations for the governance of the company as they think fit".

Thus, the memorandum lays down the scope and powers of the company and the articles govern the ways in which the objects of the company are to be carried out and can be framed and altered by the members. But they must keep within the limits marked out by the memorandum and the Companies Act.

The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members inter se.

This contract governs the ordinary rights and obligations incidental to membership in the company [*Naresh Chandra Sanyal v. The Calcutta Stock Exchange Association Ltd., AIR 1971 SC 422, (1971) 41 Com Cases 51*].

But the Articles of Association of a company are not 'law' and do not have the force of law. In Kinetic Engineering Ltd. v. Sadhana Gadia, (1992) 74 Com Cases 82 : (1992) 1 Comp LJ 62 (CLB), the CLB held that if any provision of the articles or the memorandum is contrary to any provisions of any law, it will be invalid in toto.

4.2.1 Articles Subordinate to Memorandum

The articles of a company are subordinate to and subject to the memorandum of association and any clause in the Articles going beyond the memorandum will be ultra vires. But the articles are only internal regulations, over which the members of the company have full control and may alter them according to what they think fit.

Only care has to be taken to see that regulations provided for in the articles do not exceed the powers of the company as laid down by its memorandum [*Ashbury v. Watson, (1885) 30 Ch. D 376 (CA)*].

Articles that go beyond the company's sphere of action are inoperative, and anything done under the authority of such article is void and incapable of ratification. But neither the articles nor the memorandum can authorise the company to do anything so as to contravene any of the provisions of the Act. [*See Re Peveril Gold Mines, (1989) 1 Ch 122 (CA)*]

4.2.2 Articles in Relation to Memorandum

The memorandum of a company was not clear as to the classes of shares to be issued by a company but the articles made clear the doubt by giving the power to the company to issue shares of different classes.

The relationship between the two documents was further emphasised in Guinness v. Land Corporation of Ireland, (1882) 22 Ch D 349, where it was observed: "*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 the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation and the internal regulations of the company are to be construed together... In any case it is, as it seems to me, certain which for anything which the Act of Parliament says shall be in the memorandum you must look at 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*".

Where the memorandum clearly establishes the rights of shareholders, a reference in the memorandum to the articles and an ambiguity said to arise from the construction of the articles should not be used to depart from the clear meaning of the memorandum so as to diminish those rights [*Scottish National Trust Co. Ltd. 1928 SC 499 (Scot); Kinetic Engineering Ltd. v. Sadhana Gadia, (1992) 1 Comp LJ 62 (CLB)*].

4.3 REGISTRATION OF ARTICLES

Every type of company whether public or private and whether limited by shares or limited by guarantee having a share capital or not having a share capital or an unlimited liability company must register their articles of association.

Section 26 states that a public company limited by shares may register articles of association signed by the subscribers to the memorandum. If, however, it does not register its own articles, then the articles given in Table A of Schedule I automatically becomes applicable.

Section 7(1) provides that at the time of incorporation of a company there shall be filed with the Registrar within whose jurisdiction the registered office of a company is proposed to be situated, the memorandum and articles of the company duly signed by all the subscribers to the memorandum in the prescribed manner.

Further, even if it does register articles of its own, Table A will still apply automatically unless it has been excluded or modified. There are actually three possible alternatives in which such company may adopt articles: (i) it may adopt Table A in full or, (ii) it may wholly exclude Table A and set out its own regulations in full, or (iii) it may set out its own articles and adopt part of Table A.

The alternatives (ii) and (iii) are often employed; and partial adoption of Table A has particular advantage for small companies, because of economy in printing and also because any provision of Table A is legally beyond any doubt.

As regards to a company limited by guarantee and unlimited liability company and, a private company limited by shares, Section 26 provides for compulsory registration of articles prescribing regulations for the company. However, they may adopt any of the appropriate regulations of Table A.

In any case, the articles of a company must be:

(i) printed,

(ii) divided into paragraphs, numbered consecutively,

(iii) signed by subscribers to the memorandum in the presence of atleast one witness who shall attest the 3signatures.

Also, articles are to be stamped with requisite stamp and filed along with the memorandum (Section 3).

Section 5(8) provides that in case of any company, which is registered after the commencement of Companies Act, 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Therefore, in terms of Section 5 of the Companies Act, 2013 a public company limited by shares may at its option register its Articles of Association signed by the same subscribers as to the memorandum, or alternatively it may adopt all or any of the regulations contained in Table F of First Schedule of the Act.

However nothing in Section 5 shall apply to the articles of a company registered under any previous company law unless amended under this Act [Section 5(9)].

4.4 ENTRENCHMENT PROVISIONS

The articles may contain provisions for entrenchment to the effect that specified provisions of the articles may be altered only if conditions or procedures that are more restrictive than those applicable in the case of a special resolution are met or complied with. [*Section 5 (3)*]

The Companies Act, 2013 recognizes an interesting concept of entrenchment. Essentially, the entrenchment provisions allow for certain clauses in the articles to be amended upon satisfaction of certain conditions or restrictions (such as obtaining a 100% consent) greater than those prescribed under the Act.

This provision acts as a protection to the minority shareholders and is of specific interest to the investment community. This shall empower the enforcement of any pre-agreed rights and provide greater certainty to investors, especially in joint ventures.

The provisions for entrenchment referred to in Section 5(3) shall be made either on formation of a company, or by an amendment in the articles agreed to, by all the

members of the company in the case of a private company and by a special resolution in the case of a public company. [*Section 5 (4)*]

Where the articles contain provisions for entrenchment, whether made on formation or by amendment, the company shall give notice to the Registrar of such provisions in such form and manner as may be prescribed. [*Section 5 (5)*]

4.5 STATUTORY REQUIREMENTS

The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum. The articles must not contain anything illegal or ultra vires the memorandum, nor should it be contrary to the provisions of the Companies Act, 2013.

4.5.1 Subject Matter of Articles

The articles set out the rules and regulations framed by the company for its own working. The articles of a company usually deal with the following matters:

(i) the business of the company;

(ii) the amount of capital issued and the classes of shares into which the capital is divided; the increase and reduction of share capital;

(iii) the rights of each class of shareholders and the procedure for variation of their rights;

(iv) the execution or adoption of a preliminary agreement, if any;

(v) the allotment of shares; calls and forfeiture of shares for non-payment of calls;

(vi) transfer and transmission of shares;

(vii) company's lien on shares;

(viii) exercise of borrowing powers including issue of debentures;

(ix) general meetings, notices, quorum, proxy, poll, voting, resolution, minutes;

(x) number, appointment and powers of directors;

(xi) dividends – interim and final – and general reserves;

(xii) accounts and audit;

(xiii) keeping of books – both statutory and others.

Utmost caution must be exercised in the preparation of the articles of association of a company. At the same time, certain provisions of the Act are applicable to the company "notwithstanding anything to the contrary in the articles". Therefore, the articles must contain provisions in respect of all matters which are required to be

4.5.2 Inspection and Copies of the Articles

A company shall, on being so required by a member, send to him within seven days of the requirement, on payment of one rupee, a copy of the articles. If a company makes default, the company and every officer of the company, who is in default, shall be punishable with fine upto ₹50 Lacs (Section 39).

4.6 PROVISION IN ARTICLES AS REGARDS TO EXPULSION OF A MEMBER

Section 5(2) provides that the articles shall also contain such matters, as may be prescribed. The provision to Section 5(2) provides that nothing in that sub-section shall be deemed to prevent a company from including any additional matters in its Articles, as may be considered necessary for its management.

Section 5(8) provides that in case of any company, which is registered after the commencement of the Companies Act, 2013, in so far as the registered articles of such company do not exclude or modify the regulations contained in the model articles applicable to such company, those regulations shall, so far as applicable, be the regulations of that company in the same manner and to the extent as if they were contained in the duly registered articles of the company.

Section 6 of the Companies Act, 2013 provides that:

(a) The provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a company, or in any agreement executed by it, or in any resolution passed by the company in general meeting or by its Board of Directors, whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and

(b) Any provision contained in the memorandum, articles, agreement or resolution shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be.

In the light of above provisions, if there is a provision in the Articles empowering the Directors of the company to expel any member of the company under any of the given conditions, then such a provision shall be totally inconsistent with the provisions of Section 6 of the Act. It is opposed to the fundamental principles of the company's jurisprudence and is ultra vires of the company. *[(Circular No. 32 of 1975) dated 01.11.1975)]*

But the Stock exchanges, registered under the provisions of the Companies Act, can carry such a provision in its Articles. The regulation of stock exchanges is mainly governed by Securities Contracts Regulation Act, 1956 (SCRA) and SEBI, Act, 1992 which are Special Acts.

Hence, the Articles of Stock Exchange may provide for additional matters as per SCR Act, which may not be possible for inclusion in the Articles of a company, as per the provisions of the Companies Act *[Madras Stock Exchange Ltd. v. S.S.R. Rajkumar (2003) 116 Com Cases 214 (Mad.)]*

4.7 ALTERATION OF ARTICLES

A company has a statutory right to alter its articles of association. Section 31 provides that subject to the provisions of the Act and to the conditions contained in its memorandum, a company may, by special resolution alter or add to its articles. A printed or type written copy of every special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution.

First proviso to Section 14(1) lays down that where a company being a private company alters its articles in such a manner that they no longer include the restrictions and limitations which are required to be included in the articles of a private company under this Act, the company shall, as from the date of such alteration, cease to be a private company.

Second proviso to Section 14(1) stipulates that any alteration having the effect of conversion of a public company into a private company shall not take effect except with the approval of the Tribunal which shall make such order as it may deem fit.

The right to alter just by passing special resolution is so important that a company cannot in any manner deprive itself of the power to alter its articles. Also, the power to reduce or increase the number of members in the case of a company limited by guarantee without share capital, from time to time, as given in the articles can be done by a special resolution of the general body of members.

Every alteration of the articles under this section and a copy of the order of the Tribunal approving the alteration as per Section 14(1) shall be filed with the Registrar, together with a printed copy of the altered articles, within a period of fifteen days in such manner as may be prescribed, who shall register the same. [*Section 14 (2)*]

Any alteration of the articles registered under Section 14(2) shall, subject to the provisions of this Act, be valid as if it were originally in the articles. [Section 14(3)] The right to alter the articles is so important that a company cannot in any manner, either by express provisions in the articles or by independent contract, deprive itself of the powers to alter its articles [*Walker v. London Tramway Co. (1879) 12 Ch. D. 705*].

However, inspite of the power to alter its articles, a company can exercise this power subject to certain limitations.

4.8 LIMITATIONS ON POWER TO ALTER ARTICLES

These are:

(i) The alteration must not exceed the powers given by the memorandum or conflict with the other provisions of the memorandum.

(ii) The alteration must not be inconsistent with any provision of the Companies Act or any other statute. For example, no company can purchase its own shares (Section 77) and if the articles of a company are altered so as to have the power to purchase its own shares, then such power will be void.

(iii) The altered articles must not include anything which is illegal, or opposed to public policy or unlawful.

(iv) The alteration must be bona fide for the benefit of the company as a whole. The alteration will not, however, be bad merely because it inflicts hardship on an individual shareholder.

Examples: (a) A company had a lien on all shares "not fully paid" for calls due to the company. There was only one shareholder A, who owned fully paid-up shares. He also held partly-paid shares in the company. A died. The company altered its articles striking out the words "not fully paid up" and thus gave itself a lien on all shares – whether fully paid up or not. The legal representative of A challenged the alteration on the ground that the alteration had retrospective effect.

Held: The alteration was good, as it was done bona fide for the benefit of the company as a whole, even though the alteration had a retrospective effect [Allen v. Gold Reefs of West Africa Ltd. (1900) 1 Ch. 656].

(b) By an alteration in the articles, a company was empowered to expropriate shares held by any member who was in business in competition with the company. At the time of alteration, there was only one member doing business in competition with the company. He challenged the alteration.

Held: The alteration was valid, although only one member was at that time within the ambit of alteration, as the alteration was *bona fide* and for the benefit of the company [Sidebottom v. Kershaw Leese & Co. (1920) Ch. 154 (C.A.)].

(v) The alteration must not constitute a fraud on the minority by the majority. If the alteration is not for the benefit of the company as a whole, but for majority of the shareholders, then the alteration would be bad. In other words, an alteration to the articles must not discriminate between the majority shareholders and the minority shareholders so as to give the former an advantage of which the latter have been deprived.

Example: In Brown v. British Abrasive Wheel Co. (1919) 1 Ch 290, the majority which held 98 percent of the shares passed a special resolution that upon the request of holders of $9/10^{th}$ of the issues shares, a shareholder shall be bound to sell and transfer his shares to the nominee of such holders at a fair value. The alteration was held to be invalid since it amounted to an oppression of minority.

(vi) There cannot be alteration of the articles so as to compel the existing members to take or subscribe for more shares or in any way to contribute to the share capital, unless they give their consent in writing (Section 38).

(vii) An alteration of articles to effect a conversion of a public company into a private company cannot be made without the approval of the Central Government (Section 31).

(viii) A company cannot justify breach of contract with third parties or avoid a contractual liability by altering articles.

(ix) The amended regulation in the Articles of Association cannot operate retrospectively, but only from the date of amendment [Pyare Lal Sharma v. Managing Director, J & K Industries Ltd.].

Subject to the foregoing conditions, the Articles in a company can be altered and no clause can be included in the Articles that it is not alterable. Persons who become members of a company have no right to assume that the Articles will always remain in a particular form.

Of course a section or a class of shareholders cannot be unfairly or oppressively treated. Thus, though the requisite majority of members could pass a special resolution to alter the Articles and if the alteration has the effect of making a fraud on the minority, the minority shareholders not being less than the number specified in Section 397 and 398 could move the Court for redressing their grievances.

The Courts have entertained such applications from shareholders even where they are smaller in number. As already mentioned, a company is not prevented from altering its Articles on the ground that such an alteration would be breach of a contract but an action for damages may lie against the company. [*Southern Foundries v. Shirlaw; [1940] AC 701*].

The discussion on the above matter will not be complete without referring to the rule in Foss v. Harbottle (1843) 2 Hare 461 where the court held that no individual shareholder nor a minority of shareholders in a company can take it upon himself or themselves to remedy an alleged wrong involved in the actions of directors if the said wrongful act is something which the majority can regularise and approve of.

4.9 EFFECT OF MEMORANDUM AND ARTICLES/ BINDING FORCE OF MEMORANDUM AND ARTICLES

Section 36 provides that the memorandum and articles, when registered, bind the company and its members to the same extent as if they had been signed and sealed by each member and contained covenants on the part of each member to observe and be bound by all the provisions of the memorandum and articles.

Thus, the company is bound to the members; the members are bound to the company; and the members are bound to the other members by whatever is contained in these documents. But neither a company nor its members are bound to outsiders. These relationships are discussed herein below:

Members bound to company. Each member must observe the provisions of the articles and memorandum. For instance, a company has a right of lien on members' shares, or to forfeit the shares on non-payment of calls. Every member is bound by whatever is contained in the memorandum and articles.

Example: The articles of a company contained a clause that on the bankruptcy of a member, his shares should be sold to other person and at a price fixed by the Directors. 'B', a shareholder was adjudicated bankrupt. His trustee in bankruptcy claimed that he was not bound by these provisions and should be at liberty to sell the shares at the true value. Held, that the trustee was bound by the articles, as shares were purchased by 'B' in terms of the articles. [*Borland Trustees v. Steel bros Co. Ltd. (1901) 1 Ch. 279*].

Each member is not only bound by the covenants of memorandum and articles as originally framed but as altered form time to time in accordance with the provisions of the Companies Act. The articles of associations are the regulations of the company binding on the company and on its shareholders. Further, the shareholders cannot among themselves enter into an agreement which is contrary to or inconsistent with the articles of association of the company.

Company bound to members. Similarly, a company is bound to members by whatever is contained in its memorandum and articles of association. The company is bound not only to the "members as a body" but also to the individual members as to their individual rights. The members can restrain a company from spending money on ultra vires transactions. An individual member can make the company fulfill its obligations to him, such as to send the notice for the meetings, to allow him to cast his vote in the meetings.

Members bound to member. The articles bind the members inter se, i.e., one to another so far as rights and duties arising from the articles are concerned.

It is well settled that the articles of association will have a contractual force between the company and its members as also between the members inter se in relation to their rights as such members.

Example: The articles of a company provided that whenever any member wished to transfer his shares, he was under an obligation to inform the directors of his intention and the directors were under an obligation to take the said shares equally between them at a fair value.

The directors refused to take the shares of a particular member on the ground that the Articles did not impose an enforceable liability upon them. Held: The directors were under an obligation to purchase the shares, as members of the company, in terms of the provisions of the Articles. There was a personal liability of members inter se [*Rayfield v. Hand (1960) Ch.1*].

Whether company or members bound to outsiders? No, the memorandum or articles do not confer any contractual rights to outsiders against the company or its members, even though the name of the outsiders is mentioned in the articles.

Example. The articles of a company provided that Eley should be solicitor for life to the company and should not be removed from office except for misconduct. Later on he also became a member of the company. But after employing him as a solicitor for a number of years, the company discontinued his services.

He, being a member, sued the company for damages for breach of the contract contained in the articles of association. Held: His suit was dismissed on the ground that, he, as a solicitor, was no party to the articles. He must prove a contract independent of the articles. There was no infringement of his right as a member. The breach of contract was there but in his capacity as a non-member [*Eley v. Positive Government Security Life Assurance Co., (1876) 1 Ex. D. 88*].

Whether directors are bound by whatever is contained in the articles? Yes, the directors of the company derive their powers from the articles and be subject to limitations, if any, placed on their powers by the articles. If they contravene any provisions of articles, two parties may be affected: (1) the company itself, and (2) the outsiders.

In case of contravention of the provisions of the articles, the directors render themselves liable to an action at the instance of the members. However, members may ratify the act of the director, if they so desire. But if as a result of the breach of duty any loss has resulted to the company, the directors are liable to refund to the company any damage so suffered.

Further, where the directors contravene the provisions of the articles, it may affect outsiders' interest also.

4.9.1 Constructive Notice of Articles and Memorandum

Section 610 provides that the memorandum and articles, when registered, become public documents and then they can be inspected by anyone on payment of a nominal fee.

Therefore, any person who contemplates entering into a contract with the company has the means of ascertaining and is thus presumed to know the powers of the company and the extent to which they have been delegated to the directors.

In other words, every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as 'Doctrine of Constructive Notice'. Even if the party dealing with the company does not have actual notice of the contents, it is presumed that he has "constructive notice" of them.

Examples: (i) One of the articles of a company provides that a bill of exchange to be effective must be signed by two directors. A bill of exchange is signed only by one of the directors. The payee cannot claim under the bill.

(ii) In *Kotla Venkataswamy v. Ram Murthy AIR (1934) Mad. 579*, the articles provided that all deeds and documents of the company shall be signed by the managing director, secretary and working director. A mortgage deed was accepted with secretary and working director's signature only. Held: the deed was invalid.

(iii) Similarly, if a person enters into a contract which is beyond the powers of the company, he cannot acquire any right under the contract against the company.

4.10 DOCTRINE OF INDOOR MANAGEMENT

The doctrine of constructive notice throws a burden on people entering into contracts with the company that they are presumed to have read the documents, though in fact, they might not have read them.

On the other hand, the doctrine of indoor management allows all those who deal with the company to assume that the provisions of the articles have been observed by the officers of the company.

In other words, they are not bound to enquire into the regularity of internal proceedings. An outsider is not expected to see that the company carries out its internal regulations.

Example: The directors of a company were authorised by the articles to borrow on bond such sums of money as should from time to time, by a resolution of the company in general meeting. be authorised to be borrowed. The directors gave a bond to T without the authority of any such resolution. The question arose whether the company was liable on the bond.

Held: The company was liable on the bond, as T was entitled to assume that the resolution of the company in general meeting had been passed [*The Royal British Bank v. Turquand (1856) 6 E & B 327*].

Exceptions - The doctrine of indoor management is subject to the following exceptions:

1. ***Knowledge of irregularity.*** The rule does not protect any person who has actual or constructive notice of the want of authority of the person acting on behalf of the company.

   Example: The articles of a company empowered the directors to borrow upto £ 1,000. They could exceed the limit of £ 1,000 with the consent of the company in general meeting. Without such consent, they borrowed £3,500 from themselves and took debentures. The company refused to pay the amount.

   Held: Their debentures were good to the extent of £ 1,000 only as they had notice of the internal irregularity [*Howard v. Patent Ivory Co., (38 Ch. D. 156)*].

2. ***No knowledge of articles.*** The rule cannot be invoked in favour of a person who did not consult the memorandum and articles and thus did not rely on them.

   Example: T was a director in the investment company. He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter. The articles of the company did provide that the Directors could delegate their powers to one of them. But Rama Corporation never read the articles. Later, it was found that the directors of the company did not delegate their powers to T. Plaintiffs relied on the rule of Indoor Management.

   Held: They could not, because they did not know the existence of the power to delegate [*Rama Corporation v. Proved Tin and General Investment Co. (1952)All ER 554*].

3. ***Void or illegal transaction.*** The rule does not apply to transactions which are void or illegal ab initio, e.g., forgery.

   Example: The secretary of a company forged signature of two of the directors required under the articles on a share certificate and issued the certificate without authority. The applicants claimed to be entitled to be registered as members of the company.

Held: The certificate was a nullity and the holder of the share certificate could not take advantage of the doctrine of indoor management [*Ruben v. Great Fingal Consolidated (1906) A.C 439*].

4.10.1 Exceptions to the Doctrine of Indoor Management

The above noted 'doctrine of indoor management' is, however, subject to certain exceptions.

In other words, relief on the ground of 'indoor management' cannot be claimed by an outsider dealing with the company in the following circumstances:

1. ***Where the outsider had knowledge of irregularity:*** The rule does not protect any person who has actual or even an implied notice of the lack of authority of the person acting on behalf of the company.

   Thus, a person knowing fully well that the directors do not have the authority to make the transaction but still enters into it, cannot seek protection under the rule of indoor management.

   In Howard v. Patent Ivory Co. (38 Ch. D 156), the articles of a company empowered the directors to borrow upto one thousand pounds only. They could, however, exceed the limit of one thousand pounds with the consent of the company in general meeting.

   Without such consent having been obtained, they borrowed 3,500 pounds from one of the directors who took debentures. The company refused to pay the amount.

   Held: The debentures were good to the extent of one thousand pounds only because the director had notice or was deemed to have the notice of the internal irregularity

2. ***No knowledge of memorandum and articles:*** Again, the rule cannot be invoked in favour of a person who does not consults the memorandum and articles and thus did not rely on them. In Rama Corporation v. Proved Tin & General Investment Co. (1952) 1 All. ER 554, T was a director in the company.

   He, purporting to act on behalf of the company, entered into a contract with the Rama Corporation and took a cheque from the latter.

   The articles of the company did provide that the directors could delegate their powers to one of them. But Rama Corporation people had never read the articles. Later, it was found that the directors of the company did not delegate their powers to T.

   The Plaintiff relied on the rule of indoor management. Held, they could not because they even did not know that power could be delegated.

3. ***Forgery:*** The rule of indoor management does not extend to transactions involving forgery or to transactions which are otherwise void or illegal ab initio.

   In the case of forgery it is not that there is absence of free consent but there is no consent at all. The person whose signatures have been forged is not even aware of the transaction and the question of his consent being free or otherwise does not arise.

   Consequently, it is not that the title of the person is defective but there is no title at all. Therefore, howsoever clever the forgery might have been, the personates acquire no rights at all.

Thus, where the secretary of a company forged signatures of two of the directors required under the articles on a share certificate and issued certificate without authority, the applicants were refused registration as members of the company.

The certificate was held to be nullity and the holder of the certificate was not allowed to take advantage of the doctrine of indoor management [*Rouben v. Great Fingal Consolidated (1906) AC 439*].

Forgery, in the case of a company, can take different forms. It may, besides forgery of the signatures of the authorised officials, include the execution of a document towards the personal discharge of an official's liability instead of the liability of the company.

Thus, a bill of exchange signed by the manager of a company with his own signature under words stating that he signed on behalf of the company, was held to be forgery when the bill was drawn in favour of a payee to whom the manager was personally indebted [*Kreditbank Cassel v. Schenkers Ltd. (1927) 1 KB 826*].

The bill in this case was held to be forged because it purported to be a different document from what it was in fact; it purported to be issued on behalf of the company in payment of its debt when in fact it was issued in payment of the manager's own debt.

4. ***Negligence:*** The 'doctrine of indoor management', in no way, rewards those who behave negligently. Thus, where an officer of a company does something which shall not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority.

   If he fails to make an enquiry, he is estopped from relying on the Rule. In the case of Underwood v. Bankof Liverpool (1924) 1 KB 775, a person who was a sole director and principal shareholder of a company deposited into his own account cheques drawn in favour of the company.

   Held, that, the bank should have made inquiries as to the power of the director. The bank was put upon an enquiry and was accordingly not entitled to rely upon the ostensible authority of director.

   Similarly, in the case of Anand Behari Lal v. Dinshaw & Co. (Bankers) Ltd. AIR 1942 Oudh 417, an accountant of a company transferred some property of a company in favour of Anand Behari.

   On an action brought by him for breach of contract, the Court held the transfer to be void. It was observed that the power of transferring immovable property of the company could not be considered within the apparent authority of an accountant.

   Again, the doctrine of indoor management does not apply where the question is in regard to the very existence of an agency.

   In Varkey Souriar v. Keralceya Banking Co. Ltd. (1957) 27 Com Cases 591 (Ker.), the Kerala High Court held that the 'doctrine of indoor management' cannot apply where the question is not one as to scope of the power exercised by an apparent agent of a company but is with regard to the very existence of the agency.

   This Doctrine is also not applicable where a pre-condition is required to be fulfilled before the company itself can exercise a particular power.

   In other words, the act done is not merely ultra vires the directors/officers but ultra vires the company itself — Pacific Coast Coal Mines v. Arbuthnot (1917) AC 607.

In the end, it is worthwhile to mention that Section 6 of the Companies Act, 2013 gives overriding force and effect to the provisions of the Act, notwithstanding anything to the contrary contained in the memorandum or articles of a company or in any agreement executed by it or for that matter in any resolution of the company in general meeting or of its board of directors.

A provision contained in the memorandum, articles, agreement or resolution to the extent to which it is repugnant to the provisions of the Act, will be regarded as void.

A corporation, organization or other entity set up to provide a legal shield for the person actually controlling the operation.

4.10.2 Doctrine of Alter Ego

It is used by the courts to ignore the status of shareholders, officers and directors of a company in reference to their liability in their respective capacity so that they may be held personally liable for their actions when they have acted fraudulently or unjustly. In Lennard's Carrying Co. Ltd. v. Asiatic Petroleum Co. Ltd. [1915] AC 705, Viscount Haldane propounded the "alter ego" theory and distinguished it from vicarious liability. The House of Lords stated that the default of the managing director who is the "directing mind and will" of the company, would be attributed to him and he be held for the wrong doing of the company.

4.10.3 Alterations of Memorandum or Articles to be Noted In Every Copy

Every alteration made in the memorandum or articles of a company shall be noted in every copy of the memorandum or articles, as the case may be. [Section 15(1)]

If a company makes any default in complying with the provisions of Section 15(1), the company and every officer who is in default shall be liable to a penalty of one thousand rupees for every copy of the memorandum or articles issued without such alteration. [Section 15(2)]

4.11 DISTINCTION BETWEEN MEMORANDUM AND ARTICLES

The main points of distinction between the memorandum and articles are given below:

1. Memorandum of association is the charter of the company and defines the fundamental conditions and objects for which the company is granted incorporation. Articles of association are the rules and regulations framed to govern this internal management of the company.
2. Clauses of the memorandum cannot be easily altered. They can only be altered in accordance with the mode prescribed by the Act. In some of the cases, alteration requires the permission of the Central Government or the Court. In the case of articles of association, members have a right to alter the articles by a special resolution. Generally there is no need to obtain the permission of the Court or the Central Government for alteration of the articles.
3. Memorandum of association cannot include any clause contrary to the provisions of the Companies Act. The articles of association are subsidiary both to the Companies Act and the memorandum of association.
4. The memorandum generally defines the relation between the company and the outsiders, while the articles regulate the relationship between the company and its members and between the members inter se.

5. Acts done by a company beyond the scope of the memorandum are absolutely void and ultra vires and cannot be ratified even by unanimous vote of all the shareholders. But the acts of the directors beyond the articles can be ratified by the shareholders.

4.12 PROSPECTUS

After the receipt of Certificate of Incorporation from the Registrar of companies, the promoters of a public company invite the public and financial institutions to subscribe to the capital of the company.

This notice, advertisement or other document inviting offers for the subscription to the share capital of the company is called prospectus. Only public companies can issue a prospectus. Prospectus is a valuable document issued by the company to raise the capital.

Prospectus has been defined as "any document described of issued as prospectus and includes any notice, circular, advertisement or other communication, inviting offers from the publish for the subscription or purchase of any shares."

4.12.1 Steps which are Necessary before the Issue of Prospectus

A private company is prohibited from inviting public to subscribe to its share capital and it arranges its share capital privately. The shares are subscribed by a small number of persons who are known to the promoters or are related to them by family connections.

A public company may also decide not to invite public to subscribe to its share capital and arrange its capital privately as in the case of a private company. Under such circumstances, the public company is required to submit a statement in lieu of prospectus with the Registrar of Companies atleast three days before the allotment of shares is made.

However, a public company limited by shares, generally issues shares to the public for which it have to issue a prospectus. In that case it has to follow the procedure below.

After the certificate of incorporation is obtained, the affairs of the company are taken over by the first directors appointed in accordance with the provisions of law. They will elect one of their members as the chairman of the Board of Directors, if none is named in the articles of association. The Board attends to the following matters:

(i) Appointment of various expert agencies such as bankers, auditors, secretary, etc.

(ii) Entering into underwriting contract, brokerage contracts.

(iii) Making arrangements for the listing of shares on stock exchanges.

(iv) Drafting a prospectus for the purpose of issue to the public.

The appointment of a banker is necessary as it has to receive the share application along with application moneys. The appointment of first auditor is in the hands of Board of Directors and it becomes necessary, as we shall see later, to make the appointment before the issue of prospectus. The appointment of company secretary is obligatory in case of companies, having the prescribed paid-up share capital (presently, ₹50 lakhs or more). In other companies also, the appointment of a company secretary is desirable.

4.12.2 Time of Floatation

The Board of Directors will then decide about the time of issue of prospectus. It is advisable to consider the condition of the capital market, the investors' mood, fiscal

and monetary policies of the Government and the state of business conditions before issuing a prospectus.

4.12.3 Definition of a Prospectus

A prospectus, as per Section 2(36), 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. Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice. A document shall be called a prospectus if it satisfies two things:

1. It invites subscriptions to share or debentures or invites deposits.
2. The aforesaid invitation is made to the public.

What constitutes an offer to the public? Section 67 lays down two-way criteria as to what shall constitute an invitation to the public. These are:

1. An invitation to the public shall include an invitation to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner. However, a document by the way of invitation to existing members or debenture holders to subscribe to shares or debenture by way of right is not a prospectus [Section 56(5)].
2. An invitation shall not be an invitation to the public if it cannot be calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the invitation. Thus, it will not be an invitation to public where B, a friend of A who receives the invitation, also desires to subscribe, but his offer shall be refused because he was not invited to make the same. On the other hand, it will become an invitation to public where his (B's) offer shall also be accepted.

The offering of shares of kith and kin of a director is not an invitation to the public to buy shares [Rattan Singh v. Moga Transport Co. Ltd. (1959). 20 comp. cas 165]. Further, the learned judge in this case held that in all cases the determination of the question of an offer being made to the public depends upon the facts and language of the notice and the particular circumstance of each case.

In Nash v. Lynde (1929. A.C. 1585) Justice Viscount Summer observed: "The 'public' is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve; perhaps even one. if he is intended to be the first of a series of subscribers, but makes further proceeding needless by himself subscribing the whole. The point is that the offer is such as to be open to anyone who brings his money and applies in due form whether the prospectus was addressed to him on behalf of the company or not".

If a company (other than non-banking finance company and Public Financial Institution) makes an offer to 50 or more persons, it will be treated as a public issue. In other words, private placement by a company shall come under the purview of a 'public issue'.

4.12.4 Small Depositors (Section 58AA)

To protect small depositors, Sections 58AA and 58AAA provide:

(i) A small depositor is one who has deposited, in a financial year a sum not exceeding ₹20000 in a company and includes his successors, nominees and legal representatives. However, the term does not include those small depositors (a)

who renewed their deposits voluntarily; or (b) whose repayment is not made due to death or stay order of a competent court or authority.

(ii) Any company accepting deposits shall have to inform the Tribunal, on monthly basis, the names and addresses of each small depositor about its default in repayment of deposit or payment of interest thereon. A period of 60 days is prescribed for intimation of any default to the Central Government which shall, after giving the depositor an opportunity of being heard, pass an appropriate order within 30 days from the date of receipt of such intimation from the defaulting company.

(iii) Such a defaulting company is prohibited to accept further deposits from small depositors at any time until the defaults are made good.

(iv) The total numbers of small depositors and the amount due to them in respect of which default is made the fact of whatever of interest accrued on deposits shall be stated in all future advertisements and application forms inviting deposits from the public.

Further every application form for accepting deposits shall contain a statement that the applicant has been apprised or every past default of the company in repayment of deposits and for payment of interest thereon to the small depositors.

(v) Every director of such a defaulting company shall be prohibited to be appointed as a director of any public company for 5 years from the date of the default.

(vi) No such defaulting company shall directly or indirectly make any loan to any body corporate, give guarantee or provide security or acquire security of any body corporate till such default continues.

(vii) Every non-compliance is punishable with imprisonment upto 3 years and also fine not less than ₹500 for everyday.

(viii) An aggrieved depositor is also entitled to make an application to Tribunal for redressal of his grievance against the company.

Default in acceptance or refund of deposits to be cognizable (Section 58AAA). Every offence connected with or arising out of acceptance of deposits under Section 58A or Section 58AA is a cognizable offence under the Code of Criminal Procedure, 1973.

Dating of prospectus (Section 55). Section 55 states that every prospectus must be dated and that date is deemed to be the date of publication of the prospectus.

Powers of SEBI. Section 55A provides that the provisions contained in sections 55 to 58, 59 to 81, 108-110, 112-113, 116-122, 206, 206A and 207, so far as they relate to issue and transfer of securities and non-payment of dividend shall be administered by SEBI in the following cases: (a) in case of listed companies; (b) in case of those public companies which intend to get their securities listed on any recognised stock exchange in India. In any other, case, the Central Government shall be the administering authority.

4.12.5 Contents of a Prospectus

Section 56 lays down that the matters and reports stated in Schedule II to the Act must be included in a prospectus. The format of a prospectus is divided into three parts. In the first part brief particulars are to be given about matters mentioned below:

1. ***General information.*** Under this head information is given about (i) Name and address of registered office of the company. (ii) Name/(s) of stock exchange/(s) where application for listing is made. (iii) Declaration about refund of the issue if minimum subscription of 90 percent is not received within 90 days from closure

of the issue. (iv) Declaration about the issue of allotment letters/refunds within a period of 10 weeks and interest in case of any delay in refund, at the prescribed rate, under Section 73. (v) Date of opening of the issue. (vi) Date of closing of the issue. (vii) Name and address of auditors and lead managers. (viii) Whether rating from CRISIL or any rating agency has been obtained for the proposed debentures/preference shares issue. If no rating has been obtained, this should be answered as 'No'. (ix) Names and address of the underwriters and the amount underwritten by them.

2. ***Capital structure of the company.*** (i) Authorised, issued, subscribed and paid-up capital. (ii) Size of the present issue, giving separately reservation for preferential allotment to promoters and others.

3. ***Terms of the present issue.*** (i) Terms of payment. (ii) How to apply. (iii) Any special tax benefits.

4. ***Particulars of the issue.*** (i) Objects. (ii) Project cost. (iii) Means of Financing (including contribution of promoters).

5. ***Company management and project.*** (i) History and main objects and present business of the company. (ii) Promoters and their background. (iii) Location of the project. (iv) Collaborations, if any. (v) Nature of the product. (vi) Export possibilities. (vii) Future prospects. (viii) Stock market data for share/debentures of the company including high and low price in each of the last three years and monthly high and low during the last six months, if applicable.

6. Certain prescribed particulars in regard to the company and other listed companies under the same management which made any capital issue during the last 3 years

7. Outstanding litigations relating to financial matters or criminal proceedings against the company or directors under Schedule XIII.

8. 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 over-run, etc.)

Part II of Schedule II requires the company to give detailed information. This part is further sub-divided into three parts viz., General Information, Financial Information and Statutory and Other Information.

General Information shall include information on matters like:

(i) Consent of directors, auditors, solicitors, managers to the issue, Registrars to the issue, bankers of the company, bankers to the issue and experts.

(ii) Change, if any, in directors and auditors during the last 3 years and reasons here for.

(iii) Procedure and time schedule for allotment and issue of certificates.

(iv) Names and address of company secretary, legal advisor, lead managers, co-managers, auditors, bankers to the issue.

(v) Authority for the issue and details of resolution passed therefor

Financial information includes: (i) reports of the auditors of the company with respect to its profits and losses and assets and liabilities, and the dividends paid during the five financial years immediately preceding the issue of prospectus; (ii) report by the accountants (who should be named) on the profits or losses for the preceding 5 financial years and on the assets and liabilities on a date which must not be more than 120 days before the date of the issue of the prospectus.

Statutory and other information includes information about: (i) Minimum subscription. (ii) Expenses of the issue. (iii) Underwriting commission and brokerage. (iv) Previous public or rights issue; if any, giving particulars about date of allotment, refunds, premium/discount, etc. (v) Issue of shares otherwise than for cash.

(vi) Commission or brokerage on previous issue. (vii) Particulars about purchase of property, if any. (viii) Revaluation of assets, if any. (ix) Material contracts and time and place where such documents may be inspected. (x) Debentures and redeemable preference shares or other instruments issued but remaining outstanding on the date of the prospectus and terms of their issue.

Part III of the Schedule gives explanations of certain terms and expressions used under Part I and Part II of the Schedule.

4.12.6 SEBI Guidelines Relating to Disclosure on Prospectus

Every prospectus submitted to Stock Exchange Board of India (SEBI) for vetting shall, in addition to the requirements of schedule II to the Act, contain/specify certain particulars as are announced from time to time.

4.12.7 Abridged Form of Prospectus

Section 56(3) requires that no one shall issue any form of application for shares in or debentures of a company unless the same is accompanied by a memorandum (known as 'Abridged Prospectus') containing such salient features of prospectus as may be prescribed. Thus, instead of appending full prospectus, an 'abridged prospectus' need only be appended to the application form.

In order to provide for greater disclosure of information to prospective investors so as to enable them to take an informed decision regarding investment in shares and debentures, Form 2-A has been prescribed as a format of abridged prospectus. It is further required that the abridged prospectus and the share application form should bear the same printed number and the two should be separated by a perforated line. Accordingly, the investor may detach the application form before submitting the same to the company or the designated bankers.

When 'abridged prospectus' not necessary. In the following circumstances, an 'abridged prospectus' containing the prescribed particulars as per Form 2A need not accompany the application forms: (i) In the case of a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures. (ii) When shares or debentures are not offered to the public. (iii) Where offer is made only to existing members/debenture holders of the company by way of rights, whether with or without the right of renunciation. (iv) In the case of issue of shares or debentures which are in all respects similar to those previously issued and dealt in and quoted on a recognised stock exchange.

Penalty: Non-compliance of the aforesaid provisions by any person shall attract punishment in terms of fine which may extend to ₹5,000.

Besides, the omission from a prospectus of a matter required to be included by Section 56 may give rise to an action for damage at the instance of a subscriber for share or debentures who has suffered loss thereby. It should be noted that the Act does not say that directors shall be liable, but this seems to be implied from Section 56 (4).

4.12.8 Draft Prospectus to be made Public

SEBI requires making public the draft prospectus filed with it. The lead Merchant Bankers shall simultaneously file copies of the draft document with the stock exchanges where the issue is proposed to be listed. Lead Merchant Bankers shall also

make copies available to the public. Lead Managers/stock exchanges can charge an appropriate sum from the person requesting such a copy(ies).

4.12.9 The Expert's Consent to the Issue of Prospectus

A prospectus may contain a statement purporting to be made by an expert. The term 'expert' includes an engineer, a valuer, an accountant and any other person whose profession gives authority to a statement made by him. The reports from an expert must not be included in a prospectus unless: (i) such expert is unconnected with the formation or management of the company (Section 57); (ii) he gave his consent (Section 58), (iii) he is competent to make the report, valuation or statement; (iv) a statement that he has given and not withdrawn his consent thereto appears in the prospectus (Section 58).

If the report of the expert is published in contravention of the above mentioned provisions, every person who is knowingly a party to the issue of the prospectus shall be punishable with fine up to ₹50,000 (Section 59).

4.12.10 Registration of the Prospectus (Section 60)

A copy of the prospectus duly signed by every director or proposed director must be delivered to the Registrar before its publication. Further, every copy of the prospectus on its face must state that a copy has been delivered for registration. The copy must have attached to it the following documents namely:

(i) the consent of the expert to file the prospectus;

(ii) a copy of every contract required to be specified in the prospectus or a memorandum giving full particulars of a contract not reduced to writing;

(iii) a copy of every contract appointing or fixing the remuneration of a managing director or manager;

(iv) the consent in writing of a person, if any, named in the prospectus as the auditor, legal adviser, attorney, solicitor, banker to the company to act in that capacity;

(v) consent of directors under Section 266;

(vi) a copy of the underwriting agreement, if any; and

(vii) when the persons making the reports relating to profits and losses, assets and liabilities, etc., in respect of a business proposed to be acquired have made adjustments to them, a signed statement by them stating the adjustments and the reasons for the same.

4.12.11 Prospectus by Implication

Section 64 has been designed to check the by-passing of the provisions of Section 56 as given above by making an offer of sale of shares or debentures through the medium of Issue Houses

The process involves allotment of shares to an Issue House who, in turn, will issue advertisement offering shares for sale. Since the advertisement is not issued by the company, it does not amount to a prospectus and thereby liability of non-compliance of Section 56 provisions cannot be invoked.

To check this malady, Section 64 provides that all documents containing offer of shares or debentures for sale shall be included within the definition of the term 'prospectus' and shall be deemed as prospectus by implication of law.

All enactments and rules of law as to the contents of prospectuses and as to the liability in respect of statements and omissions from prospectuses shall apply in respect of such documents.

Further, Section 64 provides that unless the contrary is proved, an allotment of, or an agreement to allot, shares or debentures shall be deemed to have been made with a view to the shares or debentures being offered for sale to the public, if it is shown:

(a) that the offer of the shares or debentures for sale to the public was made within 6 months after the allotment or agreement to allot; or (b) that at the date when the offer was made, the whole consideration to be received by the company in respect of the shares or debentures had not been received by it.

In case a document is deemed as prospectus, then it must contain the following information in addition to the information required to be stated in prospectus under Section 56: (a) the net amount of consideration received or to be received by the company in respect of the shares or debentures to which the offer relates; and (b) the place and time at which the contract under which the said shares or debentures have been or are to be allotted may be inspected.

For purposes of registration of a prospectus under Section 60, the persons making the offer of sale to the public are to be deemed as directors of the company.

Where the person making the offer is a company or a firm, the documents (i.e., deemed prospectus) must be signed by atleast two directors or one-half of the partners as the case may be.

Circumstances under which a document containing an offer for sale of shares or debentures be not deemed to be a prospectus. A document containing an offer for sale of shares or debentures is a prospectus or not depends upon whether it extends an invitation to the public to subscribe or not.

The *prima facie* test of 'public offer' or 'public invitation' is whether the terms of the offer or invitation are such that, despite its limited circulation, it is open to any person who so chooses to bring his money and apply for shares in response to the invitation.

If the offer or invitation is so open, then it constitutes a 'public offer'. If, on the other hand, an offer or invitation can be accepted only by the person to whom it is made and none other, then it will not be deemed to be an offer or invitation to the public.

The word 'public' includes any section of the public (Section 67). It may, thus, include all registered medical practitioners in Delhi, all advocates of High Court of Delhi, all Englishmen living in India.

However, in the following cases, the document inviting subscription to shares or debentures of a company shall not be deemed as invitation to the public and hence shall not be a prospectus:

1. A circular inviting existing shareholders or debenture holders of the company. Although Section 67(1) provides that such an offer shall be an offer to the public yet in view of the provisions of Section 67 (3) and (4) and that of Section 56 (5), considered view of the authors on the subject is that it does not amount to a public offer. The circular containing offer of rights shares is, therefore, not a prospectus.
2. The offering of shares to the kith and kin of a director is not an invitation to the public to buy shares [Rattan Sigh v. Moga Transport Co. Ltd. (1959)]. Such an offer, therefore, shall not be deemed as prospectus.
3. Where an invitation is made by the management of a company to selected persons for subscription or purchase by the persons receiving the offer or invitation, the shares or debentures and such invitation or offer is not calculated directly or

indirectly to be availed of by other persons, such invitation or offer shall not be deemed as prospectus [Section 67(3)]. However, this is in applicable in a case where the offer or invitation to subscribe for shares or debentures is made to fifty persons or more

In Nash v. Lyne (1929), a document marked 'strictly confidential' containing particulars of a proposed issue of shares was sent by the managing director to a co-director and through him passed on privately to a small circle of friends of the director. The House of Lords held that it was not a prospectus, as there had been no issue to the public.

4. Where a new company, by a circular, offered to buy all the shares of two existing companies and issued its own shares in exchange of those shares, it does not amount to an offer to the public as it neither involves an offer for the purchase of shares for money, nor an invitation for subscription of shares.

Is the issue of prospectus compulsory? / When prospectus is not required to be issued?
No, issue of prospectus by a company is not compulsory in the following cases:

(i) A private company is not required to issue a prospectus.

(ii) Even a public company need not issue a prospectus if the promoters or directors feel that they can mobilise resources through personal relationship and contacts. In such cases, the company is required to file a statement called 'statement in lieu of prospectus' with the Registrar of Companies.

(iii) A company may issue any forms of application for shares or debentures accompanied by a memorandum containing the prescribed salient features of prospectus (instead of prospectus). However, in such a case, a copy of the prospectus must be made available to any person on request [Section 56 (3)].

(iv) Where the application form is issued in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures [Section 56 (3)].

(v) Where the application form is issued in relation to shares or debentures not offered to the public [Section 56 (3)].

(vi) Where the shares or debentures are offered to existing holders of shares or debentures (i.e., rights issue) with or without the right of renunciation in favour of other persons [Section 56 (5)].

(vii) Where invitation to the public for subscription to the shares or debentures of a company is made in the form of an advertisement, ordinarily called as "prospectus announcement" [Section 66].

4.12.12 Shelf Prospectus and Information Memorandum (Sections 60A and 60B)

Section 60A makes provisions for a self-prospectus in certain situation. A 'shelf-prospectus' means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Any public financial institution, public sector bank or scheduled bank whose main object is financing shall file a shelf prospectus with the registrar. In such a situation such a company need not file a prospectus afresh at every stage of offer of securities by it within a period of validity not exceeding one year.

But a company filing a shelf prospectus is required to file an information memorandum (as given in Section 60B below) on all material facts relating to new charges created, changes in the financial position as have occurred between the first

offer of securities, previous offer of securities within such period as may be prescribed by the Central Government, prior to making of a second or subsequent offer of securities under the shelf prospectus.

An information memorandum shall be issued to the public along with shelf prospectus filed at the stage of the first offer of securities and such prospectus shall be valid for a period of one year from the date of opening of the first issue of securities that prospectus.

Where an update of information memorandum is filed every time an offer of securities is made, such memorandum together with the shelf prospectus shall constitute the prospectus.

4.12.13 Information Memorandum

Section 60B provides as follows as regards information memorandum:

(i) A public company making an issue of securities may circulate information memorandum to the public prior to filing of a prospectus.

(ii) A company inviting subscription by an information memorandum is bound to file a prospectus prior to the opening of the subscription lists and the offer as a red herring prospectus, atleast three days before the opening of the offer.

(iii) The 'red-herring' prospectus means a prospectus which does not have complete particulars on the price of the securities offered and the quantum of securities offered.

(iv) The information memorandum and red-herring prospectus shall carry same obligations as are applicable in the case of a prospectus.

(v) Any variation between the information memorandum and the red-herring prospectus shall be highlighted as variations by the issuing company.

(vi) Every variation as made and highlighted under (iv) is to be individually intimated to the persons invited to subscribe to the issue of securities.

(vii) In the event of the issuing company or the underwriters to the issue have invited or received advance subscription by way of cash or post-dated cheques or stock-invest, the company or such underwriters or bankers to the issue shall not encash such subscription moneys or post-dated cheques or stock invest before the date of opening of the issue, without having individually intimated the prospective subscribers of the variation and without having offered an opportunity to such prospective subscribers to withdraw their application and cancel their post-dated cheques or stock-invest or return of subscription paid.

(viii) The applicant or proposed subscriber can exercise his right to withdraw from the application on any intimation of variation within seven days from the date of such intimation and shall indicate such withdrawal in writing to the company and the underwriters.

(ix) Any application for subscription which is acted upon by the company or underwriters or bankers to the issue without having given enough information of any variations, or the particulars of withdrawing the offer or opportunity for cancelling the post-dated cheques or stock-invest or stop payments for such payments shall be void. Further, the applicants shall be entitled to receive a refund or return of its post-dated cheques or stock-invest or subscription moneys on cancellation of its application, as if the said application has never been made and the applicants are entitled to receive back their original application and interest at 15% from the date of encashment till payment of realisation.

(x) Upon the closing of the offer of securities, a final prospectus stating therein the total capital raised, whether by way of debt or share capital and the closing price of the securities and any other details as were not complete in the red-herring prospectus shall be filed in a case of listed public company with SEBI and Registrar and in any other case with the Registrar only.

4.12.14 Statement in Lieu of Prospectus (Section 70)

If a public company makes a private arrangement for raising its capital then it must file a statement in lieu of prospectus with the Registrar atleast three days before any allotment of shares or debentures can be made.

Schedule III contains a model form of a Statement in Lieu of Prospectus in pursuance of Section 70; Schedule IV contains a model form of a Statement in Lieu of Prospectus when a private company is converted into a public company in pursuance of Section 44.

If allotment of shares or debenture is made without filing the Statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine upto ₹10,000.

4.12.15 Liability for Untrue Statements in the Prospectus (Sections 62-63)

The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not omit material facts.

What is an untrue statement? According to Section 65 (1): (a) A statement included in a prospectus shall be deemed to be untrue, if the statement is misleading in the form and context in which it is included; and (b) where the omission from a prospectus of any matter is calculated to mislead, the prospectus shall be deemed in respect of such omission, to be a prospectus in which an untrue statement is included. The expression 'included' with reference to a prospectus means, included in the prospectus itself or contained in any report or memorandum appearing on the face thereof or by reference incorporated therein or issued therewith.

Example: A company issued a prospectus. All the statements included therein were literally true. One of the statements disclosed the rates of dividends paid for a number of years. But dividends had been paid not out of trading profits but out of realised capital profits. This material fact was not disclosed. Held, that the prospectus was false in material particulars and Lord Kylsant, the managing director and chairman, who knew that it was false, was held guilty of fraud [Rex v. Kylsant, (1932) 1 K. B. 442].

A person who has applied for shares in the company and who has been allotted shares has certain remedies against the company and the persons issuing the prospectus. But a buyer of shares in the open market or a subscriber to the memorandum has no such right. If, however, a prospectus is issued with the object of including persons to buy shares in the open market, any person who buys shares even in the open market on the basis of the statements made in it has a right of action if the statements are untrue or there is material omission from the prospectus.

A false statement or omission of material facts gives rise to civil as well as criminal liability.

4.12.16 Civil Liability (Section 62)

Where a prospectus is issued inviting persons to subscribe for shares in, or debentures of a company, the following persons shall be liable to pay compensation to every subscriber for loss or damage he may have sustained by reason of any untrue statement included in the prospectus on the faith of which he had applied for the shares or debentures:

(i) every person who is a director of the company at the time of the issue of the prospectus;

(ii) every person who has authorised himself to be named and is named in the prospectus as a director, or as one having agreed to become a director, either immediately, or after an interval of time;

(iii) every promoter of the company; and

(iv) every person (including an expert) who has authorised the issue of the prospectus. But an expert is liable only in respect of his own untrue statements.

Thus, an allottee of shares, who had applied for shares on the faith of prospectus containing untrue statements has remedies available against the different persons, i.e., the company, directors, promoters and experts.

Remedies Against the Company. Any person who, relying on misstatements in or omission of material facts from a prospectus, takes shares from the company may: (1) rescind the contract to take the shares; (2) claim damages. The effect of the rescission of the contract would be that the shareholder would give up the shares and get back his money with interest. He must, however, take action to rescind to contract: (a) within a reasonable time, (b) before proceedings to wind up the company have commenced; and (c) before he does anything (after he comes to know of the misstatements in the prospectus), which is inconsistent with the right to repudiate, e.g., to accept dividends. The allottee can claim relief only if he can show that the misstatement or omission was: (i) one of fact and not of law, nor an expression of opinion, (ii) material; and (iii) acted upon by him.

The second right of the allottee against the company is to sue for damages for deceit. In order to succeed, the allottee must, in addition to the three facts mentioned above (in connection with the rescission of contract), prove: (i) that those acting on behalf of the company acted fraudulently; (ii) that those purporting to act on behalf of the company were authorised to act in its behalf; and (iii) that he suffered a loss or damages.

It is important to remember that the allottee cannot both retain the shares and get damages from the company. In actual practice, suit for damages against the company is rarely filed. The usual claim against the company is for rescission of the contract of allotment. Damages are generally claimed from the directors, promoters and other persons who had authorised the issue of the prospectus personally, or from experts who had signed reports referred to in the prospectus.

Remedies against directors or promoters. A shareholder who had been induced to take shares may claim from the directors or promoters or from anyone else responsible for untrue statement occurring in the prospectus: (i) damages for fraudulent misrepresentation; (ii) compensation under Section 62; (iii) damages for non-compliance with the requirements of Section 56 regarding contents of the prospectus.

Damages for fraudulent misrepresentation. An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation. There must be an intention to defraud and that is to be proved by him. The directors, etc., will not be liable for the tort of deceit if they honestly believed the statements to be true. The facts in Derry v. Peek were as

follows: The directors of a Tramway Company issued a prospectus stating that they had the right to run tram-cars with steam power instead of with horses as before. In fact, the Act incorporating the company provided that such power might be used with the sanction of the Board of Trade. But the Board of Trade refused to give permission and the company had to be wound up. P, a shareholder sued the directors for damages for fraud. The House of Lords held that the directors were not liable in fraud because they honestly believed what they said in the prospectus to be true.

Compensation for untrue statement (Section 62). Another remedy available to an allottee of shares for misstatements in a prospectus is to file a suit for compensation under Section 62. A claim can be made, whether the statements are fraudulent or innocent. Section 65 provides that a statement is deemed to be untrue if it is misleading in the form and context in which it is issued. It is not necessary for the allottee to prove any fraud or knowledge on the part of the directors that the statement was untrue.

If a director pays damages under Section 62, he is entitled to recover contributions from his co-directors, if they, too, are guilty of misstatement, misrepresentation, untrue statement; and on the death of the co-directors, from their estates.

Defences available to avoid civil liability [Section 62(2)]. Section 62 names persons who are liable to pay compensation but certain defences are available to them. In a claim for compensation, the director may prove in defence that:

(a) he withdrew his consent to act as director before the issue of the prospectus and it was issued without his authority or consent; or

(b) the issue was made without his knowledge or consent and on becoming aware of the issue he gave reasonable public notice of that fact; or

(c) he withdrew his consent after the issue of the prospectus but before allotment and public notice was given; or

(d) he had reasonable ground to believe that the statements were true and believed them to be true; or

(e) the statement was correct and fair, summary or copy of an expert's report; or

(f) the statement was made by an official document.

Another remedy available to an allottee of shares is to file a suit for damage in case the prospectus does not include the matters required to be included in accordance with the provisions of the Act.

Remedies against expert. The allottee to the shares who has been induced to take shares on the faith of an untrue statement of an expert in the prospectus is entitled to claim from the expert: (i) damages, (ii) compensation under Section 62.

An expert is liable in damages in respect of his own untrue statement, wrong report or valuation made by him and contained in the prospectus and the same principles apply as in the case of a fraudulent or an innocent statement made by the directors. An expert is also liable to pay compensation under Section 62. However, he shall not be liable if he proves: (i) that having given his consent, he withdrew it in writing before delivery of a copy of the prospectus for registration; or (ii) that after delivery of prospectus for registration and before allotment, he became aware of the untrue statement, withdrew his consent in writing and gave reasonable public notice of the withdrawal and his reasons; or (iii) that he was competent to make the statement and believed on reasonable grounds that it was true.

Liability under Section 56. An omission from a prospectus of a matter required to be stated under Section 56 (i.e., as per Sch. II) may give rise to an action for damages at

the instance of a subscriber for shares, who has suffered loss thereby, even if the omission does not make the prospectus false or misleading. But, the plaintiff must prove that he has sustained damage by reason of the omission of a matter required to be stated in the prospectus. A director or other person sued under Section 56 may escape liability if he proves: (a) that he had no knowledge of the matter not disclosed; or (b) that the contravention arose out of an honest mistake of fact; or (c) in the opinion of the court, non compliance or contravention was not material or that the person sued ought reasonably to be excused, having regard to all the circumstances of the case.

4.12.17 Criminal Liability for Misstatement in Prospectus (Section 63)

Where a prospectus contains an untrue statement, every person authorising its issue is punishable: (i) with imprisonment for a term upto two years or (ii) with fine upto ₹50,000, or (iii) with both imprisonment and fine. However, an expert is not criminally liable in respect of misstatements in the prospectus.

Liability under Section 68. Section 68 provides that any person who, either knowingly or recklessly makes any statement, promise or forecast which is false, deceptive or misleading, or by any dishonest concealment of material facts, induces or attempts to induce another person to enter into or to offer to enter into any agreement for, or with a view of acquiring, disposing of, subscribing for, underwriting shares or debentures shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to ₹1 lakh or with both.

4.12.18 Golden Rule for Framing of Prospectus

The 'Golden Rule' for framing of a prospectus was laid down by Justice Kindersley in New Brunswick & Canada Rly. & Land Co. v. Muggeridge (1860). Briefly, the rule is:

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 shares on the faith of the representation 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 principles 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.

In Rex v. Kylsant (1932), the prospectus stated that dividends of 5 to 8 percent had been regularly paid over a long period. The truth was that the company had been incurring substantial losses during the seven years preceding the date of the prospectus and dividends had been paid out of the realised capital profit.

Held: the prospectus was false and misleading. The statement though true in itself was rendered false in the context in which it was stated.

A half truth, for instance, represented as a whole truth may tantamount to a false statement (Lord Halsbury in Aarons Reefs v. Twisa).

Thus, the persons issuing the prospectus must not include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge with might in any way affect the decision of the prospective investor to invest in the company.

4.12.19 Allotment of Shares in Fictitious Names Prohibited (Section 68A)

Following acts are punishable with imprisonment for a term extending to five years: (i) making an application to a company for acquiring or subscribing for, any shares therein under a fictitious name; or (ii) making a company to allot or register any transfer of shares therein to any other person in a fictitious name.

Also this Section should be prominently reproduced both in the prospectus as well as in application forms for shares.

Initial offer of securities to be in dematerialised form in certain cases (Section 68B). Every listed company, making initial public offer of any security for a sum of spaces ten crores or more, shall issue the same only in dematerialized form by complying with the requisite provisions of the Depositories Act, 1996 and regulations made thereunder.

4.12.20 Announcement Regarding Proposed Issue of Capital

It is very common for companies to get an announcement regarding proposed issue of shares/debentures inserted in the leading newspapers. It is not required by company law to do so. But it is done in order to invite the attention of the public to the proposed issue. On the top of the insertion it is given that, "It is only an announcement and not a prospectus", in order to avoid provisions under Section 56 for publishing an incomplete prospectus.

4.12.21 Public Deposits

The invitation and acceptance of public deposits by companies were brought within the jurisdiction of Companies Act in 1974. Rules have been framed prescribing the limits upto which, the manner in which and the conditions subject to which deposits may be invited or accepted by a company either from the public or from its members. Section 58-A and Companies (Acceptance of Deposits) Rules made thereunder contains the restrictions and limitations subject to which deposits may be invited and accepted by companies. The provisions of the Section and the summary of the important rules made thereunder are as follows:

1. ***Meaning of deposit.*** Explanation to Section 58-A defines the expression 'deposit' to mean any deposit of money with and includes any amount borrowed by a company but shall not include such categories or amount as may be prescribed in consultation with the Reserve Bank of India.

   Further rule 2(b) provides that 'deposit' means any deposit of money with and includes any amount borrowed by a company. However, the expression 'deposit' does not include.

   (i) any amount received from the Central Government or a State Government or any amount received from any other source and whose repayment is guaranteed by the Central Government or State Government or any amount received from a local authority or a foreign Government or any other foreign citizen, authority or person;

   (ii) any amount received as a loan from any banking company including a co-operative bank;

   (iii) any amount received from any of notified financial institutions;

   (iv) any amount received by a company from any other company;

   (v) any amount received from an employee of a company by way of security deposit;

(vi) any amount received by way of security or as an advance from any purchasing agent, selling agent or other agents in course of or for the purposes of the business of the company or any advance received against orders for the supply of goods or properties or for the rendering of any services;

(vii) any amount received by way of subscriptions to any shares, stock, bonds or debentures and any amount received by way of calls in advance on shares, in accordance with the Articles of the company so long as such amount is not repayable to the members under the Articles;

(viii) any amount received in trust or any amount in transit;

(ix) any amount received from a director of the company or any amount received from a relative of a director or member of a private company;

(x) any amount raised by issue of the bonds or debentures secured by the mortgage of any immovable property of the company or with an option to convert them into shares in the company. (However, in the case of such bonds or debentures secured by the mortgage of any immovable property, the amount of such bonds or debentures must not exceed the market value of such immovable property);

(xi) any amount brought in by the promoters by way of unsecured loans in pursuance of stipulations of financial institutions subject to the fulfillment of the following conditions; namely: (a) the loans are brought in pursuance of the stipulation imposed by the financial institutions in fulfillment of the obligation of the promoters to contribute such finance; (b) the loans are provided by the promoters themselves and/or by their relatives and not from their friends and business associates; and (c) the exemption shall be available only till the loans of financial institutions are repaid and not thereafter.

2. No company shall invite or accept any deposit except after the publication of an advertisement specifying therein the financial condition, management structure and other specified particulars of the company. The "renewal of deposits" are included in the "acceptance of deposits" [*Jagjivan Hiralal Doshi and Others v. Registrar of Companies (1989) 65 Comp. Cas. 553*].

3. Every deposit by a company, unless renewed in accordance with the rules made under Section 58A, shall be repaid in accordance with the terms and conditions of such deposit.

4. The form of application shall contain a declaration by the depositor that the money is not being deposited out of funds acquired by him by borrowing or accepting deposits from any other person.

5. A company cannot accept or renew deposits payable on demand.

6. Also, a company cannot accept deposits repayable before 6 months. However, deposits for less than 6 months may be accepted provided such deposits do not exceed 10% of the paid-up capital and free reserves.

   However, in no case shall a company accept deposits repayable before 3 months.

7. ***Ceiling on deposits:*** A company shall not accept deposit over and above the following limits: (a) 10 percent of the paid up capital and free reserves, in case of deposits in the form of any deposit against an unsecured debenture, deposit from a shareholder (not being a deposit accepted by a private company from its shareholders) or any deposit guaranteed by the Directors of the company; (b) any other deposit exceeding 25 percent of the aggregate of the paid-up share capital and free reserves of the company.

8. No Government company shall accept any deposits in excess of 35 percent of its paid-up capital and free reserves.

9. ***Interest on deposits:*** A Company cannot pay rate of interest exceeding the maximum rate of interest prescribed by the Reserve Bank of India, which is, at present, 11 percent compounded on monthly basis.

10. ***Penalties for contravention:*** Any deposit received in contravention of the provisions of the Act/Rules must be paid back within 30 days from the date of acceptance of such deposit. The period of 30 days may be extended by the Central Government by another period but not exceeding 30 days.

    In case of default, the company shall be subjected to fine which shall not be less than twice the amount not repaid and ½ of the fine shall be paid to the depositor. In addition, every officer of the company, who is in default, shall be punishable with imprisonment for a term which may extend upto 5 years [Section 58A (5)].

    Penalty for acceptance of deposit: Where the contravention relates to acceptance of deposit, the company may be subjected to fine which shall not be less than the amount of deposit so accepted.

    Penalty for invitation of any deposit: Where contravention relates to the invitation of any deposit, the company shall be punishable with fine which may extend to ₹ 10 lakh but shall not be less than ₹50,000.

    In both these cases of acceptance or invitation of deposit in contravention, every officer of the company who is in default shall be punishable with imprisonment for a term which may extend upto 5 years and shall also be liable to fine [H.H. Marthanda Varma & H.H. Bhupendra Narain Singh v. Registrar of Companies (1988) Comp. Cas. 125].

11. ***Register of depasits:*** According to Rule 7 every company accepting deposits shall keep at its registered office one or more registers in which there shall be entered separately in the case of each depositor the following particulars, namely: (a) name and address of the depositor; (b) date and amount of each deposit; (c) duration of the deposit and the date on which each deposit is repayable, (d) rate of interest, (e) date or dates on which repayment of interest will be made; (f) any other particulars relating to the deposit.

    The register of deposit shall be kept for a minimum period of 8 years from the financial year in which the latest entry is made in the register.

12. Where a company has failed to repay any deposit or part thereof in accordance with the terms and conditions of such deposit, the Company Law Board may, if it is satisfied, either on its own motion or on the application of the depositor, that it is necessary to do so to safeguard the interests of the company, the depositors or the public, by order direct the company to make repayment of such deposit or part thereof forthwith or within such time and subject to such conditions as may be specified in the Order – Sub-section (9).

    However in the following circumstances, application under Section 58 A (9) of the Act will NOT lie: (vide Dept. of Company Affairs Notificated dt. 8.3.1990):

    (i) Deposit made for booking/purchase of scooter, car, etc.

    (ii) Deposits accepted by financial companies like hire-purchase, finance company, a housing finance company, an investment company, a loan/ mutual benefit financial company, an equipment leasing company, a chit fund company or a company, which receives deposits under any scheme or arrangement by way of contribution/subscription or by sale of units/ certificates.

(iii) Deposits accepted by a sick industrial company covered by the Sick Industrial Companies (Special Provisions) Act, 1985, in respect of which Board for Industrial & Financial Reconstruction, has specifically, by order, suspended the operation of any contract, agreement, settlement, etc. under Section 22(3) of the said Act.

(iv) Deposits accepted by relief undertakings which are notified as such under the State Laws.

Further, it may be clarified that the depositors can, besides the relief under the Companies Act, take action against the defaulting companies under the normal civil law of the country.

13. ***Penal interest on overdue Deposits.*** Rule 8A provides that a penal rate of interest of 18 percent shall be paid for the overdue period in case of public deposits matured and claimed but remaining unpaid.

In the case of deposits made by a small investor, the penal rate of interest shall be 24 percent compoundable on annual basis.

14. ***Maintenance of liquid assets.*** Every company shall before the 30th day of April of each year, deposit or invest, as the case may be, a sum which shall not be less than 15 percent (w.e.f. 1st April, 1992) of the amount of its deposits maturing during the year ending on the 31st of March next following in any one or more of the securities prescribed in this regard. The amount so invested or deposited shall only be used in repayment of the deposits outstanding and repayable within next 31st March. At no time such investment or deposit shall fall below 10% of the deposits repayable within next 31st March.

It may be noted that all deposits of non-banking and non-financial companies are regulated under Section 58A and the Rules made thereunder.

15. ***Facility of nomination, etc.*** A depositor under Section 58A is allowed to make a nomination. The provisions of Sections 109 A and 109 B shall apply to such a nomination also.

16. ***Small Depositors – Special Provisions (Sections 58AA and 58AAA).*** The Companies (Amendment) Act, 2000 added two new Sections, viz., Sections 58AA and 58AAA, for the protection of small depositors. 'A small depositor' means a depositor who has invested in a financial year a sum not exceeding Rupees twenty thousand in a company and includes his successors, nominees and legal representatives.

If any default is made by a company in repayment of any public deposit accepted from small depositor or part thereof or any interest thereupon, Section 58AA makes it obligatory on the part of a company to provide an intimation on monthly basis to the Company Law Board within 60 days from date of default. Such intimation shall include particulars in respect of the names and addresses of each small depositor, the principal sum of deposits due to them and interest accrued thereupon

The Company Law Board shall, on receipt of the intimation, exercise on its own motion, powers conferred upon it by Sub-section (9) of Section 58A and pass an appropriate order within a period of 30 days from the date of receipt of intimation from the company.

The Company Law Board may pass the above order after giving the small depositors an opportunity of being heard. However, it shall not be necessary for a small depositor to be present at the hearing of the proceedings.

Prohibition on companies to accept further deposits: A company shall not at any time, accept further deposits from 'small depositors' unless each small depositor, whose deposit has matured, had been paid the amount of the deposit and the interest accrued thereupon. This prohibition will, however, not apply in the following cases.

(i) where such deposit has been renewed voluntarily by the small depositor; or

(ii) where repayment of the deposit has become impracticable due to the death of the small investor or a competent court or authority has stayed its repayment.

Advertisement and application form: Where a company has defaulted in repayment of deposit or part thereof or any interest thereon to a small depositor, it shall state in every future advertisement and application form for inviting deposits from the public, the total number of small depositors and amount due to them in respect of which such default has been made.

Waiver of interest due to depositors: Where any interest accrued on deposits of the small depositors has been waived, the fact of such waiver shall be mentioned by the company in every advertisement and application form inviting deposits issued after such waiver.

Loan for working capital to be used for repayment of deposits: If a company has accepted deposits from small depositors and subsequent to this obtains funds by way of loan for working capital from any bank, it shall first utilize such funds for the repayment of any deposit or any part thereof or any interest thereupon to the small depositor before applying such funds for any other purpose.

Application form to contain statement: Every application form issued by a company to a small depositor for accepting deposits from him shall contain a statement to the effect that the applicant has been apprised of:

(i) every past default by the company in repayment of deposit or interest thereon; and

(ii) the waiver of interest as above and the reasons therefor.

It may be noted that the prohibition to accept new deposit from small depositors under Sub-section (4) applies where there is a subsisting default. As against this, Sub-section (8) dealing with issue of application form to small depositors relates to past default(s) which presumably are no longer subsisting.

Default in acceptance or refund of deposit shall be cognizable. Section 58AAA makes the default in acceptance or refund of deposit to a small investor to be a cognizable offence under the Code of Criminal Procedure, 1973. However, no court shall take cognizance of the offence, in this regard, unless the complaint is made by the Central Government or any officer authorized by it in this behalf.

17. ***Exemptions.*** The provisions of Section 58A do not apply to: (1) A banking company [Section 58A (7)]. (2) Companies other than banking companies as the Central Government may after consultation with the Reserve Bank of India, specify in this behalf.

Exemption of small scale units: In pursuance of its powers, the Central Government has, after consultation with the Reserve Bank of India, granted exemption from the applicability of the provisions of Section 58A to the companies which are small scale units as per the parameters notified from time to time.

According to the notification GSR No. 73 (E), dated 2-2-1996, the exemption from the provisions of Section 58A of the Act shall be available to small scale

industrial units only if they fulfill all the following conditions, namely: (a) the paid-up capital of the company does not exceed rupees 25 lakhs; (b) the company accepts deposits from not more than 100 persons; (c) there is no invitation to public deposits; and (d) the amount of deposits accepted by the company does not exceed rupees 20 lakhs or the amount of its paid-up capital, whichever is less. Financial companies as the central government may, after consultation with the Reserve Bank of India, specify in this behalf.

However, the central government cannot exempt the financial companies from the provisions relating to advertisement contained in Section 58A(2)(b). The Central Government, in exercise of its aforesaid powers, exempted all classes of financial companies from all the provisions of Section 58A except the provisions relating to advertisement – vide Notification No. SD 523 (E), dated 18-9-1975.

Power of the Central Government to grant total or partial exemption (Section 58A (8)): The Central Government has been empowered to grant partial or total exemption from the provisions of Section 58A for a specified period to a company (or a class of companies) after consultation with the Reserve Bank of India. The Central Government is also empowered to grant extension of time to any company (or a class of companies) after consultation with the Reserve Bank in complying with these provisions.

Issue of commercial paper exempted: The Department of Company Affairs has vide notification dated 29-12-1989 exempted the class of companies which fulfill the criteria under the Non-Banking Companies (Acceptance of Deposits through Commercial Paper) Directions, 1989 from the provisions of Section 58A with respect to deposits received by non-banking companies by the issue of commercial paper as per the aforementioned Directions. The following conditions are required to be satisfied:

(i) the companies comply with the terms and conditions stipulated from time to time by the Reserve Bank of India relating to the issue of such commercial paper; and

(ii) the companies in their annual account disclose the maximum amount raised at any time during the financial year and the amount outstanding as at the end of the financial year.

18. ***Advertisement for inviting deposits (Rule 4).*** Every company intending to invite deposits or allowing or causing any person to invite deposits on its behalf is required to issue an advertisement for the purpose in a leading English newspaper and in one vernacular newspaper circulating in the State in which the registered office of the company is situated. Each advertisement should contain the particulars as prescribed in Rule 4. The advertisement must be issued on the authority and in the name of the Board of Directors of the company. It must also state the date on which the text was approved by the Board of Directors. It must contain reference to the conditions subject to which the deposits shall be accepted by the company.

According to Section 58B, an advertisement inviting a prospectus and consequently all the provisions of the Act, applicable to the prospectus, are applicable to the advertisement inviting deposits.

Signing of Advertisement: The advertisement should be signed by a majority of directors in the Board of the company, as constituted at the time the Board approved the advertisement, or their duly authorised agents, in writing and a copy of the same should be delivered to the Registrar of companies for registration. Even a letter of authority is sufficient for this purpose and power of attorney is not

necessary [Circular No. 23/75 (1)/14/75-CL (IV)] dated 25-9-1975 issued by the Department of Company Affairs].

Period of validity of advertisement and delivery of the text to the registrar: The advertisement shall remain valid for a period of 6 months from the date of the closure of the financial year in which it is issued or until the date the balance sheet is laid before the company in general meeting or where the Annual General Meeting is not held, the latest date on which the meeting should have held, whichever is earlier A fresh advertisement has to be made in each succeeding financial year for inviting deposits thereafter.

Statement in lieu of advertisement (Rule 4A): Where a company intends to accept deposits without inviting or allowing or causing any other person on its behalf, to invite such deposits, it need not issue the advertisement. It is, however, required to file with the Registrar a statement in lieu thereof containing all the particulars required to be included in the advertisement under the Rules and signed (in the same manner as the advertisement for deposits is to be signed) before accepting any deposit.

The statement in lieu of advertisement shall be valid until the expiry of 6 months from the date of closure of the financial year in which it is so delivered or until the date on which the balance sheet is laid before the company in the annual general meeting, or, where the annual general meeting for any year has not been held, the latest day on which that meeting should have been held in accordance with the provisions of the Act, whichever is earlier.

19. ***Acceptance of deposits in joint names [Rule 8(2)].*** Where depositors so desire, deposits may be accepted in joint names not exceeding three, with or without any one of the clause namely "either or survivor".

20. ***Return of deposits (Rule 10).*** Every company is required to file with the Registrar on or before 30th June every year, a return of deposits in the prescribed form furnishing information contained therein as on 31st of March of that year duly certified by the auditors of the company. A copy of the return is required to be simultaneously furnished to the Reserve Bank of India.

Issue of shares to existing shareholders. The capital is also raised by issue of rights shares to the existing shareholders (Section 81). In this case the shares are allotted to the existing equity shareholders in proportion to their original shareholding, e.g., one share against every two shares held by a member.

Public issue of shares. Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.

For raising capital from the public by the issue of shares or debentures, a public company has to comply with the provisions of the Companies Act, the Securities Contracts (Regulations) Act including the Rules made thereunder and the Guidelines and instructions issued by the concerned Government authorities, the Stock Exchange and SEBI, etc.

Management of public issue involves coordination of activities and cooperation of a number of agencies such as managers to the issue, underwriters, brokers, registrars to the issue, solicitors/legal advisors, printers, publicity and advertising agents, financial institutions, auditors and other Government/Statutory agencies such as Registrar of Companies, Reserve Bank of India, Stock Exchange, SEBI, etc.

It is advisable to keep in mind the guidelines issued by SEBI with regard to issue of shares termed as "Guidelines for Disclosure and Investor Protection" before issuing shares to the public.

Share application form to seek permanent account number. In respect of applications for value of ₹50,000 or more, the applicant or in case of applications in joint names, each of the applicant, shall mention his/her Permanent Account Number (PAN)/GIR number and income-tax circle, ward, district or the fact of non-allotment of PAN/GIR number, as the case may be and applications not complying with the provisions are liable to be rejected.

Check Your Progress

Fill in the blanks.

1. The _____ is a document that contains the purpose of the company as well as the duties and responsibilities of its members defined and recorded clearly. It is an important document which needs to be filed with the Registrar of Companies.
2. As regard a company _____and _____and, a private company limited by_____, Section 26 provides for compulsory registration of articles prescribing regulations for the company.
3. The _____ shall be made either on formation of a company, or by an amendment in the articles agreed to by all the members of the company.
4. Neither a company nor its members are bound to_____.
5. In case of default, the company shall be subjected to fine which shall not be less than _____the amount not repaid and _____ of the fine shall be paid to the depositor.

4.13 LET US SUM UP

- The Articles of Association of a company have a contractual force between company and its members as also between the members inter se in relation to their rights as such members.
- The articles regulate the internal management of the affairs of the company by way of defining the powers of its officers and establishing a contract between the company and the members and between the members inter se.
- The articles of a company are subordinate to and subject to the memorandum of association and any clause in the Articles going beyond the memorandum will be ultra vires.
- The articles must be printed, divided into paragraphs, numbered consecutively, stamped adequately, signed by each subscriber to the memorandum and duly witnessed and filed along with the memorandum.
- The provision to Section 5(2) provides that nothing in that Sub-section shall be deemed to prevent a company from including any additional matters in its Articles, as may be considered necessary for its management.

- The company is bound to the members; the members are bound to the company; and the members are bound to the other members by whatever is contained in these documents.
- The law allows all those who deal with the company to assume that the provisions of the articles have been observed by the company. This is known as the 'doctrine of indoor management.'
- An outsider is not expected to see that the company carries out its internal regulations.
- After the receipt of Certificate of Incorporation from the Registrar of companies, the promoters of a public company invite the public and financial institutions to subscribe to the capital of the company.
- A public company limited by shares, generally issues shares to the public for which it have to issue a prospectus.

4.14 LESSON END ACTIVITY

A limited company is formed with its articles stating that one Mr. Srivastava shall be the solicitor for the company and that he shall not be removed except on the grounds of misconduct. Can the company remove Mr. Srivastava from the position even though he is not guilty of misconduct?

4.15 KEYWORDS

Articles of Association: The Articles of Association is a document that contains the purpose of the company as well as the duties and responsibilities of its members defined and recorded clearly.

Public Offer/Public Invitation: A public offering is the sale of equity shares or other financial instruments by an organization to the public in order to raise funds for business expansion and investment.

Initial Public Offering (IPO): An initial public offering (IPO) is the first time that the stock of a private company is offered to the public.

Shelf Prospectus: Shelf prospectus is a type of public offering where certain issuers are allowed to offer and sell securities to the public without a separate prospectus for each act of offering and without the issue of further prospectus.

Doctrine of indoor management: This doctrine enunciates that any person dealing with the company is entitled to assume that he provisions of the article have been observed by the company.

Prospectus: It 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.

4.16 QUESTIONS FOR DISCUSSION

1. Define articles of association. Can articles of association be altered?
2. State the relation of a memorandum of association with the articles of association.
3. Explain the doctrine of ultra vires in the context of joint stock companies.

4. Explain the interrelationship of doctrine of constructive notice with the doctrine of indoor management. State the exceptions, if any, to the doctrine of indoor management.
5. What is a prospectus? Who are liable for misstatements in a prospectus? Explain the extent of civil and criminal liability for such misstatements.
6. Write a short note on statement in lieu of prospectus.
7. State the restrictions and limitations on inviting and accepting deposits by companies.
8. What is a misstatement in a prospectus? And, what are the defences available to a director for any misstatement in a prospectus?

Check Your Progress: Model Answer

1. Articles of Association
2. Limited by guarantee, unlimited liability company, shares
3. Provisions for entrenchment
4. Outsiders
5. Twice, ½

4.17 SUGGESTED READINGS

S.S Gulshan, *Business Law,* Third Edition, 2006, Excel Books, New Delhi

S.S Gulshan. *Mercantile Law.* Third Edition, 2006, Excel Books, New Delhi

G. Vijayaragavan Iyengar. *Introduction to Banking,* 2007, Excel Books, New Delhi, India

K.C. Garg, R.C., Chawla, Vijay Gupta, *Company Law,* Kalyani Publishers, Ludhiana

Company Law Journal, *Company Law Journal (India) Pvt. Ltd.*, New Delhi

UNIT III

LESSON

5

SHARES

CONTENTS

Contd...

5.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Discuss the meaning of a share, share vs. share certificate vs. stock and its types
- Elucidate in detail the meaning and types of preference share and equity share
- Explain the meaning of share capital, alteration of share capital, reduction of capital, and reduction of share capital without the sanction of the court
- Describe the transfer and transmission of shares
- State the procedure of transfer, transfer of shares under depository system and transmission of shares
- Identify the distinction between transfer and transmission
- Recognise and state the shareholders vs. members of the company and modes of acquiring membership

5.1 INTRODUCTION

Sources of capital broadly include equity capital and preference capital. There are various ways to raise capital which include preferential allotment, employee stock option, issue of rights shares, issue of shares with differential voting rights. It involves various approvals, disclosures, filings, maintenance of records, etc. which are prescribed under Chapter IV of the Companies Act 2013.

Besides Companies (Share Capital and Debentures) Rules, 2014 prescribes various aspects such as disclosures in the directors' report, matters to be stated in the explanatory statement to the resolution, prescribed forms as to maintenance of records, filings with registrar and so on.

After reading this lesson you will be able to understand the regulatory aspects and the broader procedural aspects involved in different types of issue of capital covering the Companies Act, 2013 and Companies (Share Capital and Debentures) Rules, 2014.

5.2 MEANING OF A SHARE

Section 2(46) defines a share "as a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied". This definition does not bring out the meaning of a share in its true perspective. A share signifies the following:

(i) The interest of a shareholder in the company; the right to receive dividend, attend meetings, vote at the meeting and share in the surplus assets of the company, if any, in the event of the company, being wound up [Bacha F. Guzdar v. Commissioner of Income Tax, Bombay, L. R. 617 (S. C.)];

(ii) The liability of the shareholder in the company to pay calls on shares until fully paid up;

(iii) The right of the shareholder to transfer the shares subject to the articles of association (For this purpose Section 82 classifies shares as movable property transferable in the manner provided in the articles);

(iv) Binding covenants on the part of the company as well as the shareholder, as given in the Articles of the company

Thus, a share of a company in the hands of a shareholder signifies a bundle of rights and obligations [Viswanath v. East India Distilleries (1957) 27 Comp. Cas. 175]. But a share is not a negotiable instrument [C.I.T. v. Associated Industrial Dev. Co. (1969) 2 Comp. L.J. 19].

Section 83 requires that each share in a company having a share capital must be distinguished by its appropriate number.

The Companies (Amendment) Act, 1999 amended Section 82 to the effect that for the word 'shares', the words 'shares and debentures' shall be substituted.

5.2.1 Share vs. Share Certificate

A common man uses 'share' and 'share certificate' to mean the same. It is, therefore, important to note the exact differences between the two. Section 82, in this regard describes a share as a moveable property transferable in the manner provided by the articles of the company and Section 84, on the other hand, describes a 'share certificate' to mean a certificate, under the common seal of the company, specifying any shares held by any member. Section 84 further suggests that a share certificate shall be *prima facie* evidence of title of the member to such shares. Thus, whereas 'share' represents property, 'share certificate' is an evidence of the title of the member to such property.

Each share bears a distinctive number and it is not the same as share certificate number, the two are different. In fact, a share certificate may be an evidence of many shares, say 50,100 or even 1 lakh. Thus, whereas there will be only one number as the share certificate number for one certificate, there will be as many distinctive numbers in respect of shares as are evidenced by the share certificate.

Thus, the share certificate being prima facie evidence of title, it gives the shareholder the facility of dealing more easily with his shares in the market. It enables him to sell his shares by showing at once marketable title.

Also, a share certificate serves as an estoppel as to payment against a *bona fide* purchaser of the shares from alleging that the amount stated as being paid on shares has not been paid. However, a person who knows that statements in a certificate are not true cannot claim an estoppel against the company.

5.2.2 Share vs. Stock

The share capital of a company is divided into a number of indivisible units of specified amount. Each of such unit is called a 'share'. Thus, if the share capital of the company is ₹5,00,000 divided into 50,000 units of ₹10 each, unit of ₹10 shall be called a share of the company.

The term 'stock' may be defined as the aggregate of fully paid-up shares of a member merged into one fund of equal value. It is a set of shares put together in a bundle. The 'stock' is expressed in terms of money and not as so many shares. Stock can be divided into fractions of any amount and such fractions may be transferred like share. Such fractions, unlike the shares, bear no distinctive numbers.

Table 5.1: Main Points of Difference

	Share	Stock
1.	A share has a nominal value.	A stock has no nominal value.
2.	A share has a distinctive number which distinguish it from other shares.	A stock bears no such number.
3.	Share can be issued originally to the public.	A company cannot make an original issue of stock. Stock can be issued by existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid-up.	A stock can never be partly paid-up it is always fully paid-up.
5.	A share cannot be transferred in fractions. It is transferred as a whole	A stock may be transferred in any fractions.
6.	All the shares are of equal denomination.	Stock may be of different denominations.
7.	Shares can be issued by any company public or private.	Stock can be issued only by a public company limited by shares

A company cannot make an original issue of the stock. A company limited by shares may, if authorised by its Articles by a resolution passed in the general meeting, convert all or any of its fully paid-up shares into stock [Section 94 (1) (c)].

On conversion into stock, the register of members must show the amount of stock held by each member instead of the number of shares. The conversion does not affect the rights of the members in any way.

5.2.3 Types of Shares

As mentioned above, a share carries certain rights and is subject to some obligations. A company may issue all shares with same rights and obligations. However, it may issue different types of shares with different rights and liabilities attached to them so as to satisfy the needs of different types of investors.

In such a case, the rights attached to the different classes of shares are called class rights. The class rights normally relate to voting, dividends, return of capital or share in the surplus assets of the company (the last two rights being available at the time of winding up) and are invariably set out in the articles of the company.

The most common types of shares are: (1) Preference; (2) Equity or Ordinary; and (3) Deferred or Founders'. A public company and a private company which is a subsidiary of a public company may not issue shares other than equity, preference and cumulative convertible preference shares (CCPS).

The Companies (Amendment) Act, 2000, substituted a new section for Section 86. It provides that the share capital of a company limited by shares shall be of two kinds only, namely: (a) equity share capital (i) with voting rights, or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed; (b) preference share capital.

5.3 PREFERENCE SHARE: MEANING AND TYPES

A preference share is one which carries the following two rights over holders of equity shares: (i) a preferential right in respect of dividends at a fixed amount or at a fixed rate and (ii) a preferential right in regard to repayment of capital on winding up.

The preference or priority of the preference shareholders is in relation to the rights of equity shareholders [Section 85].

5.3.1 Participating and Non-participating

If a preference share carries either one or both of the following rights then it is known as participating share: (i) to participate further in the profits either along with, or after payment of a certain rate of dividends on equity shares, (ii) to participate in the surplus assets at the time of winding up [Section 85]. Thus, if a preference share does not carry either of these rights, then it will be known as non-participating share. It should be remembered that preference shares are always presumed to be non-participating unless expressly described as participating.

5.3.2 Cumulative and Non-cumulative

If a preference share carries the right for payment of arrears in dividend from future profits, then such a share is known as cumulative preference share. Thus, dividends not paid in any year or years accumulate and are paid out whenever profits are available. If a preference share does not carry the right to dividend in arrears, then such a preference share is known as non-cumulative or simple. Thus, if no profits are available in a year, the holders get nothing nor can they claim unpaid dividend in subsequent years. It should be remembered that preference shares are always presumed to be cumulative unless expressly described as non-cumulative.

5.3.3 Redeemable Preference Shares

A preference share which can be redeemed upon the resolution of the Board of Directors, if the articles so provide, is known as redeemable preference share (Section 80). A company can issue redeemable preference shares if it complies with the following requirements:

(i) such shares are to be issued as redeemable preference shares; shares issued earlier cannot be converted into redeemable preference shares;

(ii) there must be authority in the articles to issue redeemable preference shares;

(iii) the shares can be redeemed only when they are fully paid up;

(iv) the shares may only be redeemed: (a) out of profits of the company which would otherwise be available for dividend, or (b) out of the proceeds of a new issue of shares – not necessarily of redeemable preference shares made for the purpose of redemption;

(v) if there is a premium payable on redemption, it must have been provided out of profits or out of the share premium account before the shares are redeemed;

(vi) where the shares are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed is to be transferred out of profits to the "Capital Redemption Reserve Account".

The redeemable preference shares can be redeemed by the company either at a fixed date, or after a certain period of time, or at the option of the company. But redemption of such shares shall not be taken as reducing the nominal capital of the company.

The Companies (Amendment) Act, 1999 amended Section 80 to the effect that for the words "share premium account", the words "security premium account" shall be substituted.

5.3.4 Irredeemable Preference Shares

No company limited by shares can issue any preference shares which are irredeemable or are redeemable after the expiry of ten years from the date of issue.

Also, once the company has redeemed the shares, or it is about to redeem them, it may issue new shares upto the same nominal amount and it will be presumed that the preference shares were never redeemed. In such a situation the company's capital is not deemed to be increased and, therefore, no stamp duty is to be paid. This privilege is available only if the redemption takes place within one month after the making of the fresh issue [Section 80 (4)].

Non-compliance with the provisions of Section 80 will render the company and every officer of the company who is in default liable to a fine upto ₹10,000.

5.3.5 Voting Rights of Preference Shareholders

The preference shareholders will vote only on matters directly relating to preference shares. Section 87 (2) mentions the following matters which relate to preference shares and preference shareholders can vote on them: (i) any resolution for winding up of the company; (ii) any resolution for the reduction or repayment of share capital; (iii) any resolution at any meeting, if dividend on cumulative preference shares remains unpaid for at least two years. Holders of non-cumulative preference shares shall have a right to vote on all resolutions, if their dividends are in arrear for the two financial years during a period of six years ending with the financial year preceding the meeting [Section 87(2)].

5.4 EQUITY SHARE

'Equity share' means a share which is not preference share (Section 85). The rate of dividend is not fixed. The Board of Directors recommended the rate of dividend which is then declared by the members at the Annual General Meeting. Before recommending dividend on equity shares, the Board of Directors have to comply with the provisions of law as regards depreciation, transfer of a minimum amount to reserves, etc.

The holders of equity shares have voting rights in proportion to the paid-up equity capital of the company [Section 87(1)].

Section 86, provides that the new issues of share capital of company limited by shares shall be of two kinds only, namely: (a) equity share capital- (i) with voting rights, or (ii) with differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions, as may be prescribed; (b) preference share capital prior to the amendment to the Companies Act in 2000, public companies were not allowed to issue equity shares with differential rights.

Thus, companies are now allowed to issue non-voting equity shares. However, these shares can be issued subject to the rules and conditions prescribed by the Department

of Companies Affairs. The Department of Companies Affairs has notified 'The Companies (Issue of Share Capital with Differential Voting Rights) Rules 2001' which, inter alia, provide for the following:

1. Share with differential voting rights, including non-voting shares, cannot exceed 25 percent of the total issued share capital.
2. The company issuing such shares must have distributable profits in the three years preceding such issues.
3. Companies will not be allowed to convert its equity capital with regular voting rights into shares with differential voting rights and *vice versa*.
4. Issue of such shares must be approved by the shareholders by way of resolution in a general meeting:

   The notice of the general meeting to shareholders shall carry an explanatory statement detailing, inter alia, the following: (a) voting rights which shares with differential rights will carry; (b) scale or proportion to which the voting rights of such shares will vary; (c) that the members holding equity shares with differential rights will be entitled to bonus and rights shares of the same class.
5. Listed companies must obtain the shareholders' approval through postal ballot.
6. Companies which have defaulted in filing annual returns during the preceding three years or have failed to repay their deposits or interest thereon on due date or redeem debentures on due date or pay dividend after becoming due, will not be eligible to issue shares with differential rights.
7. Again, companies which have defaulted in addressing investors' grievances will not be allowed to issue such shares.
8. Issue of such shares must be authorized by Articles of Association of the company
9. The company should not have been convicted of any offence under SEBI Act, 1992, Securities Contract (Regulation) Act, 1956 and FEMA, 1999.
10. Members holding equity shares with differential rights shall be entitled to bonus and rights issue of the same class.

    The holders of equity shares carrying voting rights shall have voting rights in proportion to the paid-up equity capital of the company [Section 87(1)].

5.4.1 Cumulative Convertible Preference Shares (CCPS)

The Government vide its guidelines dated 19th August, 1985 permitted issue of another class of shares by public limited companies, called cumulative convertible preference shares.

The Guidelines issued by the Ministry of Finance in this regard are as follows:

1. ***Applicability.*** The guidelines will apply to the issue of CCPS by public limited companies which propose to raise finance.
2. ***Objects of the issue.*** The objects of the issue of the above instruments should be for any of the following purposes: (a) Setting-up of new projects; (b) Expansion or diversification of existing projects; (c) Normal capital expenditure for modernisation; and (d) Working capital requirements.
3. ***Quantum of issue.*** The amount of CCPS cannot exceed the equity shares offered to the public for subscription. However, in case of projects assisted by financial

institutions, the quantum of issue would be approved by the financial institutions/banks.

4. ***Terms of issue.*** (i) CCPS would be deemed to be equity issue for the purpose of calculation of debt equity ratio as may be applicable; (ii) The entire issue of CCP would be convertible into equity shares between the end of 3 years and 5 years as may be decided by the company and approved by the Controller of Capital Issue CCI (Now, SEBI); (iii) The conversion of the CCP shares into equity would be deemed as being one resulting from the process of redemption of the preference shares out of the proceeds of a fresh issue of shares made for the purposes of redemption; (iv) The rate of preference dividend payable on CCP would be 10%; (v) The guidelines in respect of preference shares regarding ratio of 1:3 as between preference shares and equity shares would not be applicable to this new instrument; (vi) On conversion of the preference shares into equity shares, the right to receive arrears of the dividend, if any, on the preference shares up to the date of conversion shall devolve on the holder of the equity shares on such conversion. The holder of the equity shares shall be entitled to receive the arrears of dividend as and when the company makes profit and is able to declare such dividend; (vii) The aforesaid CCP share would have voting rights as applicable to preference share under the Companies Act; (viii) The conversion of aforesaid preference shares into equity shares would be compulsory at the end of 5 years and the aforesaid preference shares would not be redeemable at any stage.
5. ***Denomination.*** The face value of CCP share will ordinarily be ₹100 each.
6. ***Listing.*** CCP shares shall be listed on one or more stock exchange in the country.
7. ***Articles of association of the company and resolution of the general body:*** The articles of association of the company proposing to issue CCPs should contain a provision for issue of such shares. Further, the company must submit with the application to the SEBI/a certified copy of a special resolution in this regard under Section 81(1A) of the Companies Act, duly passed in the general meeting of the company. This resolution must approve the issue of CCP shares and provide for compulsory conversion of the preference shares between the 3rd to 5th year as the case may be.

5.4.2 Deferred or Founder's Shares

A pure private company can issue shares of a type other than those discussed above (Section 90). Thus, it may issue what are known as deferred shares. As deferred shares are normally held by promoters and directors of the company, they are usually called founder's shares. They are usually of a smaller denomination, say one rupee each. However, they are generally given equal voting rights with equity share which may be of higher denomination, say ₹10 each. As regards to payment of dividend to holders of such shares, the articles usually provide that these shares will carry a dividend fixed in relation to the profits available after dividends have been declared on the preference and equity shares. Thus, the promoters, founders and directors have a very direct interest in the success of such a company; the greater the profits of the company the higher their dividends.

It is to be remembered, however, that as and when the private company converts itself into a public company, it will have to alter its capital structure and retain only equity share capital and preference share capital (including CCPs), if any.

5.4.3 Non-voting Shares

'Non-voting shares' as the term suggests are shares which carry no voting rights. These are contemplated as altogether a different class of shares which may carry

additional dividends in lieu of the voting rights. The Companies (Amendment) Act, 2000 provided for issue of such type of equity shares under Section 86.

5.4.4 Sweat Equity Shares

The Companies (Amendment) Act, 1999, allowed issue of sweat equity shares subject to fulfillment of certain conditions. A new Section 79A was inserted for this purpose. The provisions are:

Notwithstanding anything contained in Section 79, a company may issue sweat equity shares of a class of shares already issued if the following conditions are satisfied:

(a) the issue of sweat equity shares is authorised by a special resolution passed by the company in the general meeting;

(b) the resolution specifies the number of shares, current market price, consideration, if any and the class or classes of directors or employees to whom such equity shares are to be issued;

(c) not less than one year has, at the date of the issue elapsed since the date on which the company was entitled to commence business;

(d) the sweat equity shares of a company whose equity shares are listed on a recognised stock exchange are issued in accordance with the regulations of SEBI.

In case of a company whose shares are not listed on any recognised stock exchange, the sweat equity shares may be issued in accordance with the guidelines as may be prescribed. For the purposes of this section, the expression 'a company' means company incorporated, formed and registered under this Act and includes its subsidiary company incorporated in a country outside India.

The expression "sweat equity shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever named called.

However, all the limitations, restrictions and provisions relating to equity shares shall be applicable to such sweat equity shares.

5.4.5 Employee Stock Option Scheme/Employee Stock Purchase Plan

'Employee stock option' means the option given to the whole-time directors, officers or employees of a company which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by a company at a pre-determined price. SEBI issues guidelines regarding these schemes/plans.

5.4.6 Issue of Shares at Par, at Premium and at Discount

A company may issue shares at par, or at premium, or at a discount.

Issue at par. Shares are deemed to have been issued at par when subscribers are required to pay only the amount equivalent to the nominal or face value of the shares issued. For instance, if the face value of a share is ₹10 and the buyer is required to pay thereon ₹10 only – nothing more nothing less – then he will be said to be holder of a share issued at par.

Issue at a premium. In the above example, if the buyer is required to pay more than the face value of the share, e.g., ₹12.50 on a share of ₹10, then the share is said to be issued or sold at a premium.

The Companies Act, 1956 does not stipulate any conditions or restrictions regarding the issue of shares by a company at a premium. However, it does impose conditions regulating the utilisation of the amount of premium collected on shares. Firstly, the premium cannot be treated as profit and, therefore, cannot be distributed as dividend. Secondly, the amount of premium received in cash and the equivalent of it received in kind must be kept in a separate bank account known as the 'Share Premium Account'. Thirdly, the amount of share premium is to be maintained with the same sanctity as the share capital. Fourthly, the share premium account cannot be treated as free reserves as it is in the nature of capital reserve. Fifthly, the amount credited to the 'Share Premium Account' can be used only for the purposes listed in Section 78(2).

In accordance with the provisions of Section 78(2), the share premium can be utilised only for the following purposes: (i) to pay for unissued shares of the company to be issued to members of the company as fully paid bonus shares; (ii) to write off the preliminary expenses of the company; (iii) to write off the expenses or the commission paid or discount allowed on, any issue of shares or debentures of the company; (iv) to provide for the payment of premium payable on the redemption of redeemable preference shares or of any debentures of the company.

The issue of shares at a premium does not require the sanction of any governmental agency. The company is, however, required to ensure compliance of SEBI guidelines in this regard.

The Companies (Amendment) Act, 1999 amended Section 78 to the effect that for the word 'share' in the section, the word 'securities' shall be substituted.

Issue at a Discount. If the buyer of shares is required to pay less than the face value of the share, e.g., ₹8.50 on a share of ₹10, then the share is said to be issued or sold at a discount. However, the issue of shares at a discount is regulated by law and Section 79 provides for certain conditions subject to which shares can be issued at a discount. These conditions are:

(a) The issue of shares at a discount is authorised by a resolution passed by the company in general meeting and sanctioned by the Company Law Board.

(b) The issue must be of a class of shares already issued.

(c) The maximum rate of discount must not exceed 10 percent or such higher rate as the Central Government may permit in any special case.

(d) Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.

(e) The shares to be issued at a discount must be issued within two months of the sanction by the Central Government or within such extended time as it may allow; and

(f) Every prospectus at the date of its issue must mention particulars of the discount allowed on the issue of shares, or the exact amount of the discount as has not been written off. In case of default, the company and every officer of the company who is in default shall be punishable with fine which may extend to fifty rupees.

5.4.7 Bonus Shares

A company may, if the articles so provide, capitalise profits by issuing fully paid-up shares to the members thereby transferring the sums capitalised from the profit and loss account or Reserve Account to the Share Capital [Section 205 (3)]. Such shares are known as bonus shares and are issued to the existing members of the company free of charge.

The issue of bonus shares is regulated not only by the Companies Act, 1956 but also by the guidelines issued by SEBI in this regard.

5.4.8 Rights Shares

The existing members of the company have a right to be offered shares, when the company wants to increase its subscribed capital. Such shares are known as "right shares" but they are not issued free of charge.

Section 81 provides that where at any time after the expiration of two years from the date of incorporation of the company or after one year from the date of the first allotment of shares, whichever is earlier, a public company limited by shares, issues further shares within the limits of the authorised capital, its directors must first offer these shares to the existing holders of equity shares in proportion, as nearly as circumstances admit, to the capital paid up on their shares at the time of the further issue.

The company must give notice to each of the equity shareholders, giving him the option to buy the shares offered to him by the company. The shareholders must be informed of the number of shares he has the option to buy. He must be given at least fifteen days to decide whether he would exercise his option or not. If the shareholder does not inform the company of his decision, he shall be deemed to have declined the offer.

Unless the articles of the company otherwise provide, the directors must state in the notice of offer the fact that the shareholder has also the right to renounce the offer, in whole or part, in favour of some other person who need not be member of the company. If the shareholder declines or is deemed to have declined or if the person in whose favour the renunciation is made declines to buy the shares, the company's directors may dispose of those shares in such manner as they may think fit.

Exceptions: However, the company may, by special resolution in general meeting, decide that the directors need not offer the shares in the further issue to the existing equity shareholders and that they may dispose them off in any manner whatsoever. But where, it has been possible to muster ordinary majority only, the directors may not offer the shares to the existing equity shareholders, if permission is obtained from the Central Government. Further, Section 81 does not apply to a private company. Thus, a private company need not offer its further issue first to existing shareholders. Directors are free to offer them in the manner they deem fit. Further, Section 81 is not applicable in the case of issue of shares against conversion of loans or debentures.

SEBI has issued guidelines regarding Rights Issues.

Duty of transferor to transferee in respect of rights shares. There may be pending transfers at the time when a rights issue takes place. This raises the question whether the transferor of an unregistered transfer is under any obligation towards his transferee to apply for the rights shares for the benefit of the transferee. The Supreme Court in R. Mathalone v. Bombay Life Assurance Co. Ltd. AIR 1953 SC 385 has observed that after the transfer form has been executed, the transferor cannot be held to undertake any additional financial burden in respect of the shares at the instance of the transferee where, after the transfer of shares, but before the company had registered the transfer, the company offered rights shares to its members. The transferor could not be compelled by the transferee to take up on his behalf the rights shares offered to the transferor and all that he could require the transferor to do was to renounce the rights issue in the transferee's favour.

Allotment to renouncee. As per Section 81(1)(c), unless the Articles of the company otherwise provide, the letter of offer of rights shall be deemed to include a right to

renounce the shares offered to a member in favour of any other person; and the notice sent to him must contain a statement to this effect. When a shareholder renounces any of the rights shares offered to him, in favour of third person, it is not in the nature of transfer of such shares. The Board of Directors, therefore, cannot refuse to allot the shares to the renouncee unless the Articles so provide – Re Simo Securities Trust Ltd. (1972) 42 Comp. Cas. 457.

However, the right to renounce shares is not available to members of Section 43A company even to the limited extent of renouncing in favour of other members. The Articles of a company may contain provisions enabling members to transfer shares to each other, but that is different from a renunciation of shares – Needle Industries' case (supra).

In the case of shares registered in joint names, any of the joint holders may lodge a letter of renunciation.

5.4.9 Conversion of Loans or Debentures into Shares

There is one more situation where the existing equity shareholders may lose the right to be offered the shares, discussed above. Sub-sections (4) to (7) of Section 81 provide for such a contingency.

A company may issue shares to its lenders or debentures-holders who have been given the option to convert their loan or debentures into shares. However, the company can do so only if such conversion has been approved before the issue of debentures or raising of the loan by a special resolution and also by the Central Government. But no such special resolution is necessary where the lender or the debenture-holder is either the Government or any institution specified by the Central Government in this behalf.

Moreover, the Central Government may allow a Government holder of debentures or a Government lender of money to the company to ask for shares of the company in lieu of the loan or debenture amount, even though the instrument of loan or debenture does not contain any option for conversion. A copy of every such order issued by the Central Government must be laid in draft before each House of Parliament while it is in session for a total period of thirty days.

Section 94A empowers the Central Government to administratively increase the authorised capital when conversion is ordered by it and the company does not have shares to issue and has not increased its share capital by ordinary resolution.

5.5 MEANING OF SHARE CAPITAL

It means the capital of a company, or the figure in terms of so many rupees divided into shares of a fixed amount, or the money raised by the issue of shares by a company.

As mentioned above, a public company and its subsidiary can issue only two kinds of shares, viz., preference and equity. Therefore, such a company can have only two kinds of share capital by issue of preference shares and equity shares, viz., preference share capital and equity share capital. The expression "Preference Share Capital" and "Equity Share Capital" are used in the following different senses:

Nominal, authorised or registered capital. This is the sum stated in the memorandum as the share capital of a company with which it is proposed to be registered. This is the maximum amount of capital which it is authorised to raise by issuing shares and upon which it pays stamp duty. As we shall see later, when the original amount of the authorised capital is exhausted by issue of shares, it can be increased by passing an ordinary resolution.

Issued capital. It is that part of the authorised capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorised capital.

Subscribed capital. It is that portion of the issued capital which has been subscribed for by the purchasers of the company's shares. The amount of subscribed capital is either equal to or less than the issued capital.

Called-up capital. The company may not call up full amount of the face value of the shares. Thus, the called-up capital represents the total amount called-up on the shares subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

Thus, uncalled capital represents the total amount not called up on shares subscribed and the shareholders continue to be liable to pay the amounts as and when called. However, the company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. For this purpose, a special resolution is required to be passed and then it is known as Reserve Capital or Reserve Liability (Section 99).

Paid-up capital. Paid-up capital is the amount of money paid-up on the shares subscribed.

5.5.1 Alteration of Share Capital

Section 94 provides that, if the articles authorise, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as:

- to increase its authorised share capital by such amount as it thinks expedient by issuing fresh shares;
- to consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
- to convert all or any of its fully paid-up shares into stock and reconvert the stock into fully paid-up shares of any denomination;
- to sub-divide its shares, or any of them, into shares of smaller amount than fixed by the memorandum, but the proportion paid and unpaid on each share must remain the same;
- to cancel shares which, at the date of the passing of the resolution in this behalf, have not been taken or agreed to be taken by any person.

These five clauses are now explained.

Increase of authorised share capital. A company, limited by shares, if the articles authorise, can increase its authorised share capital by passing an ordinary resolution.

Within 30 days of passing of the resolution, a notice of increase in the share capital must be filed with the Registrar. On receipt of the notice, the Registrar shall record the increase and also make any alterations which may be necessary in the company's memorandum or articles or both. If default is made in filing the notice, the company and every officer of the company who is in default shall be punishable with fine up to ₹50 per day during which the default continues (Section 97).

Consolidation and sub-division of shares. Consolidation is the process of combining shares of smaller denomination. For instance, 10 shares of ₹10 each are consolidated into one share of ₹100. Sub-division of shares is just the opposite of consolidation, i.e., one share of ₹100 is divided into 10 shares of ₹10 each. Once a resolution has

been passed, a copy of the resolution is required to be sent within thirty days to the Registrar.

Conversion of shares into stock and vice versa: Stock is simply a set of fully paid-up shares put together and is transferable in any denomination or fraction. On the other hand, a share is transferable as a whole; it cannot be split into parts.

For example, a share of ₹10 can be transferred as a whole; it cannot be transferred in parts. But if 10 shares of ₹10 each fully paid are converted into stock, of ₹100, then the stockholder can transfer stock, say, worth ₹17 also.

Section 94 empowers a company to convert its fully paid-up shares into stock by passing a resolution in general meeting, if its articles authorise such conversion. A notice is to be filed with the Registrar within thirty days of the passing of the resolution specifying the shares so converted.

It is to be noted that stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also, stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.

When shares are converted into stock, the shareholders are issued stock certificates. In the Register of Members, the amount of stock is written against the name of a particular member in place of number of shares. The stockholder is as much a member of the company as a shareholder.

Diminution of share capital. Sometimes, it so happens that shares are issued, but are not taken up by the members of the public and, therefore, not allotted. Section 94 provides that a company may, if its articles authorise, by resolution in general meeting, cancel shares which at the date of the passing of the resolution in that behalf have not been taken or agreed to be taken by any person and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital which is discussed herein below.

5.5.2 Reduction of Capital

Sections 100-105 provide for the reduction of share capital. A company limited by shares, if so authorised by its articles, may, by special resolution, which is to be confirmed by the Court reduce its share capital:

(i) by reducing or extinguishing the liability of members for uncalled capital, e.g., where a share of ₹10 on which ₹5 are paid, is treated as a share of ₹5 fully paid-up. In this way the shareholder is relieved from liability on the uncalled capital;

(ii) by paying off or returning capital which is in excess of the wants of the company, e.g., where there is a share of ₹10 fully paid-up, reduce it to ₹5 and pay back ₹5 to the shareholder;

(iii) pay off paid-up capital on the understanding that it may be called up again, e.g., a share of ₹10 is fully paid-up, on which ₹2.50 may be returned to the shareholder on the condition that when necessary, the company may call it up again. Thus, the difference between method (i) and this method is that the uncalled liability is not extinguished in the latter;

(iv) a combination of the preceding methods;

(v) write off or cancel capital which has been lost or is not represented by available assets, e.g., a share of ₹10 fully paid-up is represented by ₹7.50 worth of assets. In such a situation, reality can be re-introduced into the balance sheet position of the

company by writing off ₹2.50 per share. This is the most common method of reduction of capital. The assets side of the balance sheet may include useless assets, fictitious goodwill, preliminary expenses, discount on issue of shares and debentures, etc. These assets are either cancelled or their values are reduced to the extent they are useless. Correspondingly, share capital on the liability side is reduced.

Procedure for reduction of capital. After passing the special resolution for the reduction of capital, the company has to apply to the Court by way of petition to confirm the resolution under Section 101. The creditors are entitled to object where the proposed reduction of share capital involves either: (1) the diminution of liability in respect of unpaid capital; or (2) the payment to any shareholder of any paid-up share capital, or in any other case, if the Tribunal so directs.

To enable the creditors to object, the Court settles a list of such people. If any creditor objects, either his consent to the proposed reduction should be obtained or he should be paid off or his payment secured. However, the Court may dispense with the consent of a creditor on the company securing payment of the debt or claim by appropriating the full amount or that fixed by the Court.

Section 102 states that if the Court is satisfied that either the creditors entitled to object have consented to the reduction, or that their debts have been paid or secured, it may confirm the reduction. It may also direct that, the words "and reduced" be added to the company's name for a specified period and that the company must publish the reasons for the reduction and the causes which led to it.

Section 103 provides for registration of the Court's order with the Registrar. The company has also to send the minutes giving details of the share capital as altered. The reduction of share capital takes effect only on registration of the Tribunal's order with the Registrar and not before. The Registrar will issue a certificate of registration which will be a conclusive evidence that both the requirements of the Act have been complied with and that the share capital is now as set out in the minutes. The registered minutes are deemed to be substituted for the corresponding capital clause in the memorandum, thereby altering the memorandum within the meaning of Section 40. The copies of the memorandum which will be issued subsequently must, therefore, be in accordance with the articles.

Section 104 provides that after the reduction of capital, the members cease to be liable for calls as regards to the amount by which the nominal amount of their shares has been reduced. If, however, any creditor entitled to object to the reduction of share capital is not entered on the list of creditors, then every member at the time of the registration of the L.L.B order and minutes is liable to contribute for the payment of that debt.

Section 105 provides for punishment with imprisonment extending to one year or with fine or both, if any officer of the company knowingly conceals the name of any creditor entitled to object to the reduction or misrepresents the nature or amount of claim or debt or abets such concealment or misrepresentation.

5.5.3 Reduction of Share Capital without the Sanction of the Court

There are some cases in which there is reduction of share capital and no confirmation by the Court is necessary. These are:

(i) ***Forfeiture of shares.*** A company may, in pursuance of its articles, forfeit shares for non-payment of calls.

(ii) ***Surrender of shares.*** It is a shortcut to forfeiture. It may be accepted by the company under circumstances where its forfeiture is justified. It has the effect of releasing the shareholder whose surrender is accepted from liability on shares.

(iii) ***Diminution of capital.*** This has already been explained. Section 94 clearly states that diminution of capital does not amount to reduction of capital.

(iv) ***Redemption of redeemable preference shares.*** This has already been explained as provided by Section 80.

(v) ***Purchase of shares of a member by the company under Section 402.*** The Company Law Board may order the purchase of shares of any member of the company by the company, under certain circumstances.

Reduction of capital vs. diminution of capital. Reduction of capital involves working off past losses against capital cancellation of the uncalled capital or repayment of surplus capital. It may involve reduction of issued capital, subscribed or paid up share capital. Diminution of capital denotes cancellation of the authorised or issued capital (but not subscribed). Diminution of capital does not constitute a reduction of capital within the meaning of the Companies Act. The distinction between reduction and diminution of capital is as follows:

1. Diminution of capital is the reduction of the issued capital. Reduction of capital involves reduction of subscribed or paid up capital; there is no reduction of issued capital.
2. Both require authorisation by Articles but whereas 'diminution' can be effected by an ordinary resolution (if so authorised by Articles), reduction of capital cannot be effected without passing a special resolution.
3. 'Reduction' requires confirmation by Court (Section 100) but 'diminution' needs no confirmation by the Court (Section 94).
4. In case of 'reduction', Court may order the company to add the words 'and reduced' after its name [Section 102 (3) but no such order can be passed in case of 'diminution' Section 94].
5. In case of 'diminution', notice is to be given to Registrar within 30 days from the date of cancellation whereupon the Registrar shall record the notice and make the necessary alteration in the Memorandum of Association and Articles of Association. In case of 'reduction' more detailed procedure has been prescribed though there is no time limit as in case of 'diminution'.

5.5.4 Purchase of its own Shares by a Company (Section 77)

No company limited by shares and no company limited by guarantee and having a share capital, shall have power to buy its own shares, unless the consequent reduction of share capital is effected and sanctioned by the court in pursuance of Section 100 to 104 or of Section 402. Further, no public company and no private company which is a subsidiary of a public company can directly or indirectly (through loans or guarantee) provide financial assistance to any person to buy shares in the company or in its holding company.

If default is made in compliance of Section 77, then the company and every officer of the company in default shall he punishable with a fine upto ₹1 lakh.

There are, however, certain exceptions to Section 77. They are: (1) A company may redeem its redeemable preference shares issued under Section 80; or (2) A banking company may lend money for the purpose in the ordinary course of its business; or (3) A company in pursuance of scheme for the purchase of fully paid-up shares in the company to be held by trustees for the benefit of its employees including salaried

directors, may advance loan for the purchase; or (4) A company may advance loans to its bona fide employees (excluding directors or managers) to enable them to purchase fully paid shares for amount not exceeding six months' salary or wages of each employee; or (5) An unlimited company can purchase its own shares; or (6) A private company which is not a subsidiary of a public company may advance loan or offer guarantee for purchase of its shares. However, even such a company cannot purchase its own shares.

The Companies (Amendment) Act, 1999 inserted three new Sections - 77A, 77AA and 77B. The companies have been allowed to buy-back their shares subject to certain safeguards. SEBI (Buy Back of Securities) Regulations, 1998 have also been issued. These are:

1. Section 77A provides that a company may purchase its own shares or other specified securities (also known as "buy-back") out of (i) its free reserves; or (ii) the securities premium account; or (iii) the proceeds of any shares or other specified securities. However, no buy-back of any kind of shares or other specified securities shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities.

2. This buy-back is allowed only if the following conditions are satisfied; (a) the buy-back is authorised by the articles: (b) a special resolution has been passed in general meeting of the company authorising the buy-back; (c) the buy-back does not exceed 25% of the total paid-up capital and free reserves of the company; also, the buy-back of equity shares in any financial year shall not exceed 25% of the total paid-up equity capital in the financial year: (d) the ratio of the debt owed by the company must not be more than twice the capital and its free reserves after such buy-back. However, the Central Government may prescribe a higher ratio of the debt for a class or classes of companies. The term 'debt' here includes all amounts of unsecured and secured debts; (e) all the shares or other specified securities, for buyback must be fully paid-up; (f) the buy-back of the shares or other specified securities listed on any recognised stock exchange is in accordance with the regulations made by SEBI; (g) the buy-back in respect of unlisted shares or other specified securities is in accordance with the guidelines prescribed.

3. The notice of the meeting at which special resolution is proposed to be passed shall be accompanied by an explanatory statement stating (a) a full and complete disclosure of all material facts; (b) the necessity for the buy-back; (c) the class of security intended to be purchased under the buy-back; (d) the amount to be invested under the buy-back; (e) the time-limit for completion of buy-back. In any case every buy-back shall be completed within 12 months from the date of passing the special resolution.

4. The buy-back may be (a) from the existing security-holders on a proportionate basis; or (b) from the open-market; or (c) from odd lots, (i.e., where the lot of securities of a public company, whose shares are listed on a recognised stock exchange, is smaller than such marketable lot, as may be specified by the stock exchange; or (d) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity.

5. Where a company has passed a special resolution to buy-back its own shares or other securities, it shall, before making such buy-back file with the Registrar of Companies and the SEBI a declaration of solvency in the prescribed form. This declaration is to be verified by an affidavit to the effect that the Board of Directors of the company has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year of the date of

declaration adopted by the Board and signed by at least two directors of the company, one of whom shall be the managing director, if any.

However, in case if a company whose shares are not listed on a recognised stock exchange, no such declaration need be filed with SEBI.

Where a company buys back its own securities, it shall extinguish and physically destroy the securities so bought back within seven days of the last day of completion of buy-back.

6. Where a company completes a buy-back of its shares or other specified securities, it shall not make further issue of the same kind of shares [including allotment of further shares under Section 81 (1)] or other specified securities within a period of 24 months except by way of bonus issue or in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.

7. Where a company buys-back the securities, it shall maintain a register of the securities so bought, the consideration paid for the securities bought back, the date of cancellation of securities, the date of extinguishing and physical destroying of securities and such other particulars as may be prescribed.

8. A company shall, after the completion of the buy-back, file with the Registrar and SEBI, a return containing such particulars relating to the buy-back within 30 days of such completion as may be prescribed. However, no such return need be filed with SEBI, in the case of a company whose shares are not listed on any recognised stock exchange.

9. If a company makes a default in complying with the above provisions, the company or any officer of the company who is in default shall be punishable with imprisonment for a term which may extend upto 2 years, or with fine which may extend upto ₹50,000 or with both.

10. For the purposes of this Section – (i) 'specified securities' includes employees' stock option or other securities as may be notified by the Central Government from time to time, (ii) "free reserves" shall have the meaning assigned to it in Section 372A.

11. Transfer of certain sums to capital redemption reserve account (Section 77AA). Where a company purchases its own shares out of free reserves, then a sum equal to the nominal value of the shares so purchased shall be transferred to the capital redemption reserve account and details of such transfer shall be disclosed in the balance sheet.

12. Prohibition for buy-back in certain circumstances (Section 77B). This section provides that no company shall directly or indirectly purchase its own shares or other specified securities (a) through any subsidiary company including its own subsidiary companies, or (b) through any investment company or group of investment companies, or (c) if a default, by the company, in repayment of deposit or interest payable thereon, redemption of debentures, or preference shares or payment of dividend to any shareholder or repayment of any term loan or interest payable thereon to any financial institution or bank, is subsisting.

13. Further no company shall directly or indirectly purchase its own shares or other specified securities in case it has not complied with provisions of Sections. 159, 207 and 211.

5.5.5 Raising of Capital/Issue of Shares

Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in three ways. (i) By private placement of shares; (ii) By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and (iii) By inviting the public to subscribe for shares in the company through a prospectus.

Private placement of shares. A private company limited by shares is prohibited by the Act and the Articles from inviting the public for subscription of shares or debentures. It also need not file statement in lieu of prospectus. Its shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

A public company can also raise its capital by placing the shares privately and without inviting the public for subscription of its shares or debentures. In this kind of arrangement, an underwriter or broker finds persons, normally his clients who wish to buy the shares. He acts merely as an agent and his function is simply to procure buyer for the shares, i.e., to place them. Since no public offer is made for shares, there is no need to issue any prospectus. However, under Section 70, such a company is required to file with the Registrar a statement in lieu of prospectus atleast 3 days before making allotment of any shares or debentures.

As per the guidelines issued by SEBI in June, 1992, private placement of shares should not be made by subscription of shares from unrelated investors through any kind of market intermediaries. This means promoters share should not be contributed by subscription of those shares by unrelated investors through brokers, merchant bankers, etc. However, subscription of such shares by friends, relatives and associates is allowed.

By an offer for sale. Under this arrangement, the company allots or agrees to allot shares or debentures at a price to a financial institution or an Issue-house for sale to the public. The Issue-house publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [Section 64(1)]. On receipt of applications from the public, the Issue-house renounces the allotment of the number of shares mentioned in the application in favour of the applicant purchaser who becomes a direct allottee of the shares.

By inviting public through prospectus. This is the most common method by which a company seeks to raise capital from the public. The company invites offers from members of the public to subscribe for the shares or debentures through prospectus. An investor is expected to study the prospectus and if convinced about the prospects of the company, apply for shares.

5.6 TRANSFER AND TRANSMISSION OF SHARES

Transfer of shares refers to the transfer of title to shares, voluntarily, by one party to another. Transmission of shares means the transfer of title to shares by the operation of law.

Transferability is an important feature of a share in a company registered under the Companies Act, from which emanates another feature of a company – perpetual succession.

In this section we shall discuss the meaning of transmission of shares and procedure to execute transmission.

5.6.1 Procedure of Transfer

Section 108 requires the transfer to be in a proper instrument of transfer known as Share Transfer Form which is required to be presented to the Registrar before it is signed and filled up by the transferor. The Registrar will stamp or otherwise endorse thereon the date on which it is so presented to him. However, the transfer form is not necessary in case of transfer of securities effected through the depository as per the Depositories Act, 1996.

A company shall not register a transfer of shares, unless a proper instrument of transfer duly stamped and executed by the transferor and by the transferee, has been delivered to the company along with the share certificate.

A reading of Section 108 of the Companies Act, 1956 and Section 12 of the Indian Stamp Act, 1899, clearly shows that the instrument of transfer of shares should bear the requisite stamps and the adhesive stamps should be cancelled at the time of affixation of such stamps and execution of the document.

If these requirements are not complied with, then the instrument, although bearing an adhesive stamp but not cancelled, cannot be said to be an instrument 'duly stamped'. Accordingly, transfer shall not be valid.

Section 108 (1A)(b) requires that the stamps should be affixed before delivery to the documents.

Lodging the transfer. Every instrument of transfer completed in all respects, be delivered to the company:

(i) in the case of shares dealt in or quoted on a recognised stock exchange, at any time before the date on which the Register of members is closed, for the first time after the date endorsed by the Registrar or within 12 months from the date of such endorsement, whichever is later;

(ii) in any other case, within two months from the date of such endorsement.

Section 110 provides that the application for the registration of transfer may be made either by the transferor or the transferee. Where it is made by the transferor and relates to partly paid-up shares, the company must give notice of application by prepaid registered post to the transferee. If the transferee does not object to the transfer within two weeks from the receipt of the notice, then his name may be entered on the Register of members. With regards to an application by the transferee or by the transferor relating to fully paid-up shares, no such notice is required.

Transfer of shares held in joint names. In case of shares held in joint names, the transfer form must be signed by all of them, unless a specific authorisation is made in favour of any or some of them.

Sale of shares by tax recovery officer. Where the Tax Recovery Officer is required to transfer shares to a person who has purchased them, the Tax Recovery Officer may execute such documents or make such endorsement as required.

Transfer when complete. Transfer becomes complete and the transferee becomes a shareholder only when the transfer is registered in the company's register [Mathrubhumi Printing & Publishing Co. Ltd. v. Vardhaman Publishers Ltd. (1992) 73 Comp. Cas. 80 (Ker.)].

5.6.2 Transfer of Shares under Depository System

The Depositories Act, 1996 has paved the way for an alternate mode of effecting transfer of shares. Investors will, however, have the choice of continuing with the existing share certificates and adopt the existing mode of effecting their transfer.

Upon entry into the depository system, share certificates belonging to the investors will be 'dematerialised' and their names entered in the books of participants as beneficial owners. The investors' names in the register of companies concerned will be replaced by the name of depository as the registered owner of the securities. The investors will, however, continue to enjoy the economic benefits from the shares as well as voting rights on the shares concerned.

Shares in the depository mode shall cease to have distinctive numbers. Issuers of new securities will give investors the option either to receive physical securities or to join the depository mode. While investors holding share certificates may opt to become beneficial owners in a depository system, those investors opting to exit from a depository will be allowed to do so and claim share certificates from the company by substituting their names as the registered owner in place of the depository.

Ownership changes in the depository system will be made automatically on the basis of delivery vs. payment. There will be a regular, mandatory flow of information about the details of ownership in depository's record to the company concerned. If the latter has any reservations about the admissibility of share acquisition by any person, the company will be entitled to make an application to the Company Law Board for rectification of the ownership records with depository. During the pendency of company's application with the Company Law Board, the transferee would be entitled to all the rights and benefits of the shares except voting rights which will be subject to the orders of the Company Law Board.

Insertion of new section, viz., Section 111A. Subject to the provisions of this section, viz., Section 111A, the shares or debentures and any interest therein of a company, other than a private company shall be freely transferable.

The Company Law Board may, on an application made by a depository, the company, participant or investor or the Securities and Exchange Board of India within two months from the date of transfer of any shares or debentures held by a depository or from the date on which the instrument of transfer or the intimation of transmission was delivered to the company, as the case may be, after such inquiry, as it thinks fit, direct the company or depository to rectify register or record if the transfer of the shares or debentures is in contravention of any of the provisions of the Securities and Exchange Board of India Act, 1992 or regulations made thereunder. However, the Tribunal may, at its discretion, make an interim order as to suspend the voting rights before making or completing such enquiry.

The provisions of this section shall not restrict the right of a holder of shares or debentures, to transfer such shares or debentures and any person acquiring such shares or debentures shall be entitled to voting rights unless the voting rights have been suspended by an order of the Tribunal.

Notwithstanding anything contained in this section, any further transfer, during the pendency of the application with the CLB, of shares or debentures shall entitle the transferee to voting rights unless the voting rights in respect of such transferee have also been suspended.

5.6.3 Transmission of Shares

Transmission of shares takes place (i) when the registered shareholder dies or (ii) when he is adjudicated an insolvent; or (iii) if the shareholder is a company, it goes into liquidation.

On the death of a shareholder, his shares vest in his legal representative. The legal representative can sell the shares without being registered, if he does not wish to be registered as a member of the company.

But subject to the provisions of the Articles, he is entitled to be put on the Register of Members, if he so desires. For this purpose, the company is bound to accept production of Probate or Letter of Administration or Succession Certificate as sufficient evidence of his title.

In case the legal representative elects to become a member, he must send a written and signed notice, called Letter of Request, to the company notifying his decision. If he elects to transfer, he shall notify the election after executing a transfer of the shares. All rules relating to the right of transfer and registration of transfer will apply to such notice and transfer.

On the insolvency of a shareholder, his shares vest in the Official Assignee or Official Receiver, who can sell and transfer the shares or to get himself registered as a member.

Where a shareholding company goes into liquidation, the liquidator may sell and transfer the shares.

5.6.4 Distinction between Transfer and Transmission

The following are points of distinction between transfer and transmission of shares.

(i) Transfer takes place by a voluntary and deliberate act of the transferor, while transmission is the result of operation of law.

(ii) In case of transfer, the transferor and the transferee have to execute an instrument of transfer, while the shares are transmitted on the death, insolvency of a member and instrument of transfer is not required; only a proof of his title to the shares is required.

(iii) Transfer is the normal method of transferring property in the shares, whereas transmission of shares takes place only on death, insolvency of a shareholder.

5.6.5 Certification of Transfer (Splitting of Shares) (Section 112)

Where a shareholder desires to sell only some of the shares represented by a share certificate or to sell them to different buyers, then a problem may arise in that, the transferor is required to hand over the share certificate to the buyer to be lodged along with the share transfer form with the company and this may not be possible in such a situation. Therefore, to overcome this problem, a practice has come into being whereby the transferor lodges the certificate and transfer form with the company with a request to certify the transfer. The company obliges by endorsing a statement to the effect that a share certificate covering those transfers has been lodged with the company. The certification is normally done on the transfer form itself.

When the transfer is lodged with the company and passed, the company cancels the old certificate and sends a 'certification of transfer', for the shares transferred, to the transferee and a balance certificate/ticket, for those retained, to the transferor. The 'certification of transfer' and the 'balance ticket' are exchanged for share certificates as and when they are ready. In case of shares being sold to two or more transferees, the certification of transfers is exchanged for the new certificates.

Section 112 provides that certification is merely a representation by the company to any person acting on the faith of it that there have been produced to the company such documents, as on the face of them, show a prima facie title in the transfer, but in no way, it is a representation that the transferor has any title to the shares.

However, where any person acts on the faith of an erroneous certification made by a company negligently, the company shall be under the same liability to him as if the certification has been made fraudulently.

The 'Certification of transfer' to be valid should satisfy the following requirements: (i) the instrument of transfer should be certificated with the words 'Certificate lodged' or words to the like effect; (ii) the person issuing the certification instrument must be a person authorised to issue such instruments of transfer on the company's behalf; (iii) the certification must be signed by any officer or servant of the company or any other person, authorised to certificate transfers on company's behalf. Where a body corporate has been so authorised, it may be signed by any officer or servant of that body corporate.

However, it may be noted that there is no statutory obligation cast on the company to certify transfers.

5.6.6 Right of Transferees Pending Registration of Transfer (Section 206A)

For transferring the ownership rights in shares, it is necessary that the company must register the transfer and make new entries in the register of members. But, as we know, the transfer of shares is not registered immediately on delivering the instrument of transfer to the company.

In fact, the company is given two months' time to either register the transfer or refuse it. But, what shall be the position of the respective parties during this period? The question assumes importance because the company during this period may issue bonus shares or make offer of rights.

Till the company has registered the transfer, the name of the transferor continues to appear in the register of members. Technically, therefore, the transferor continues to be a lawful owner and the member of the company but the transferee is the beneficial owner.

In order to protect the interest of transferees in such a situation Section 206 A provides that where any instrument of transfer of shares has been delivered to the company for registration and transfer has not been registered, the right to dividend, rights shares and bonus shares shall be kept in abeyance.

The dividend in relation to such shares shall be transferred to the special account called "Unpaid Dividend Account" as per Section 205A unless the company is authorised by the registered holder to such share in writing to pay such dividend to the transferee specified in such instrument of transfer.

5.6.7 Statutory Restrictions on Transfer of Shares (Sections 108A-108I)

These sections provide as follows:

Restriction on acquisition of certain shares (Section 108A). Section 108A prohibits the holding of more than 25% of the paid-up share capital of a company without the previous approval of the Central Government.

Restriction on transfer of shares (Section 108B).

- Everybody corporate or bodies corporate under the same management which holds, where singly or in the aggregate, 10% or more of the nominal value of the subscribed equity share capital of any other company must, before transferring one or more of such shares, give to the Central Government an intimation of its or their proposal to transfer such share.
- Where, on receipt of the intimation or otherwise, the Central Government is satisfied that as a result of such transfer, a change in the composition of the Board of Directors of the company is likely to take place and that such change would be prejudicial to the interests of the company or to the public interest, it may issue

any of the following orders: (a) No such share shall be transferred to the proposed transferee. Or

(b) Where such share is held in a company engaged in any industry specified in Schedule XV, such share shall be transferred to the Central Government or to such Corporation owned or controlled by that Government as may be specified in the direction.

- If the Central Government does not make any direction within sixty days from the date of receipt by it of the intimation given, the above provisions with regard to the transfer of such shares shall not apply.

Resolution on the transfer of shares of foreign companies. Section 108C prohibits anybody corporate or bodies corporate under the same management, which holds, or hold in the aggregate, 10% or more of the nominal value of the equity share capital of a foreign company, having an established place of business in India, to transfer any share in such foreign company to any citizen of India or anybody corporate incorporated in India except with the previous approval of the Central Government. The Central Government shall however not refuse such permission unless it is of opinion that such transfer would be prejudicial to the public interest.

Power of central government to direct companies not to give effect to the transfer (Section 108D).

- Where the Central Government is satisfied that as a result of the transfer of any share or block of shares of a company, a change in the controlling interest of the company is likely to take place and that such change would be prejudicial to the interest of a company or to the public interest, that Government may direct the company not to give effect to the transfer of any such share or block of shares and – (a) where the transfer of such share or block of shares has already been registered, not to permit the transferee or any nominee or proxy of the transferee, to exercise any voting or other rights attaching to such share or block of shares; and (b) where the transfer of such share or block of shares has not been registered, not to permit any nominee or proxy of the transferor to exercise any voting or other rights attaching to such share or block of shares.

- Where any direction is given by the Central Government under (1), the share or the block of shares referred to therein shall stand retransferred to the person from whom it was acquired and thereupon the amount paid by the transferee for the acquisition of such share or block of shares shall be refunded to him by the person to whom such share or block of shares stands or stand retransferred.

- If the refund referred to in (2) is not made within the period of thirty days from the date of the direction referred to in (1), the Central Government shall, on the application of the person entitled to get the refund, direct, by order, the refund of such amount and such order may be enforced as if it were a decree made by a civil court.

- The person of whom any share or block of shares stands or stand retransferred under (2) shall, on making refund under (2) or (3), be eligible to exercise voting or other rights attaching to such share or block of shares.

Time within which refusal to be communicated (Section 108E). Every request made to the Central Government for according its approval to the proposal for the acquisition of any share referred to in Section 108A or the transfer of any share referred to in Section 108C shall be presumed to have been granted unless within a period of sixty days from the date of receipt of such request, the Central Government communicates to the person by whom the request was made that the approval prayed for cannot be granted.

Nothing in Section 108A to 108D to apply to government companies, etc. (Section 108F). Nothing contained in Section 108A [except Sub-section (2) thereof] shall apply to the transfer of any share to and nothing in Section 108B or Section 108C or Section 108D shall apply to the transfer of any share by– (a) any company in which not less than 51% of the share capital is held by the Central Government; (b) any Corporation (not being a company) established by or under any Central Act, (c) any financial institution.

Applicability of the provisions of Sections 108A to 108F (Section 108G). The provisions of Sections. 108A to 108F (both inclusive) shall apply to the acquisition or transfer of shares or share capital by, or to, an individual, firm, group, constituent of a group, body corporate or bodies corporate under the same management, who or which:

(a) is, in case of acquisition of shares or share capital, the owner in relation to a dominant undertaking and there would be, as a result of such acquisition, any increase (i) in the production, supply, distribution or control of any goods that are produced, supplied, distributed or controlled in India or any substantial part thereof by that dominant undertaking, or (ii) in the provision or control of any services that are rendered in India or any substantial part thereof by that dominant undertaking, or

(b) would be, as a result of such acquisition or transfer of shares or share capital, the owner of a dominant undertaking; or

(c) is, in case of transfer of shares or share capital, the owner in relation to a dominant undertaking.

Construction of certain expressions used in Sections 108A to 108G (Section 108H). The expressions "group", "same management", "financial institution", "dominant undertaking" and "owner" used in Sections 108A to 108G (both inclusive), shall have the meanings respectively assigned to them in the Monopolies and Restrictive Trade Practices Act, 1969.

Penalty for acquisition or transfer of shares in contravention of Sections 108A to 108D (Section 108-I). Section 108I provides for penalties for non-compliance of provisions contained in Section 108A to 108D.

5.7 SHAREHOLDERS VS. MEMBERS OF THE COMPANY

Section 41 provides that: (1) 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. (2) 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. On this basis, two pre-requisites for a person to become a member of a company are: (i) the agreement in writing to take shares of the company; and (ii) the registration of his name in its register of members.

Besides, a person may also become a member of a company through the depository system. Every person holding equity share capital of a company and whose name is entered as beneficial owner in the records of the depository shall be deemed to be a member of the concerned company (vide Depository Act, 1996).

Thus, a person can agree to take shares of a company either as the subscriber at the initial stage of its formation or in any of the following manner: (a) by subscribing to its further or new shares, (b) on transfer of its shares from an existing member; (c) on acquisition or purchase of its shares (for example, take-over bid, renunciation of rights

shares by an existing member); and (d) on acquisition of its shares by devolution (for example, transmission of shares to legal heirs of a deceased member, on insolvency, upon merger/amalgamation through court's order); (e) on conversion of convertible debentures or loans pursuant to the terms of issue of such debenture or loan agreement respectively.

The fundamental difference between the subscribes who agree to take shares at the time of formation of the company and persons who agree to take shares later is that the former become members immediately on incorporation of the company, that is, they automatically become members. The latter, though having agreed to take shares, become members only after their names are registered in the register of members of the company.

5.7.1 Member and Shareholder

In the case of a company, limited by shares, the persons whose names are put on the register of members, are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right. In such a situation, the terms 'member' and 'shareholder' are interchangeably used to mean the same person.

In Srikanta Data v. Venkateshwara Real Estate Enterprises (P) Ltd. (1990) 68 Comp. Cas. 216 (Kar), it was held that unless the context otherwise requires, the word 'member' under Section 2(27) means a 'shareholder' excepting a person who is a bearer of a share warrant of the company.

But in the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder, for such a company may not have a share capital. However, sometimes a distinction is maintained between a member and a shareholder in the case of a company having a share capital.

In other words, as regards the same set of shares one person may be a member and another be the shareholder of the company. This *distinction* arises in the following situations:

1. X is a member of a company limited by shares. His name is placed on the register of members as he is holding shares in his own right and, therefore whether we call him a member or a shareholder, it is immaterial. In such a situation, the terms 'member' and 'shareholder' may be used interchangeably. Now, in the following three situation he will cease to be a shareholder, though he continues to be the member of the company:

   (a) *On sale.* X sells the shares to Y. He fills in a share transfer form and hands it over to Y. He also gives the share certificate representing the shares to Y. In return for sale of shares, he receives consideration from Y. X is no longer a shareholder as he has sold the shares and property in the shares has passed to Y. But the name of X continues to be on the Register of members till the transfer of shares is registered by the company in favour of Y.

   (b) *On death.* X dies and his property, including shares, is inherited by Y, his legal representative. X is no longer the shareholder. He is not in existence to hold the shares. Y is holding the shares in his own right and, therefore, can rightly be called the shareholder. But X continues to be the member as his name still appears on the register of members. However, as soon as Y gets his own name registered in the register of members, then X will cease to be a member.

   (c) *On becoming insolvent.* X becomes insolvent and his property, including shares, vests in the Official Receiver or Official Assignee. The Official

Receiver or Assignee is holding the shares in his own right. Therefore, *X* is no longer the shareholder, though he continues to be the member of the company.

2. A person who is holding a share warrant is a shareholder but he is not a member of the company as his name is struck off the register of members (Section 115).

3. A person who subscribes to the memorandum of association immediately becomes the member, even though no shares are allotted to him. Till shares are allotted to the subscriber, he is a member but not the shareholder of the company.

4. In the case of a company limited by guarantee having no share capital or an unlimited company having no share capital, there will be only 'members' but not 'shareholders'.

5.7.2 Modes of Acquiring Membership

A person may become a member or a shareholder of a company by any of the following ways:

1. ***By subscribing to the memorandum of association.*** The subscribers of the memorandum of a company are deemed to have agreed to become members of the company only by reason of their having signed the memorandum. A subscriber to the memorandum becomes a member, the moment the company is registered and it is not necessary that their names must have been entered in the register of members.

   Further, by subscribing the memorandum everyone of the subscribers is deemed to have contracted to become a shareholder in respect of the shares he subscribed for

2. ***By agreement and registration.*** Section 41(2) provides that apart from the subscribers of the memorandum, 'every other person who agrees in writing to become a member and whose name is entered in its register of members shall be a member of the company'. It follows that except in the case of the subscribers to the memorandum, a person does not become member of the company, until his name is duly recorded in the register of members.

   Registration of the name of a person as a member of a company may arise:

   (a) ***Upon application and allotment.***

   (b) ***By transfer.*** The member may acquire shares from an existing member by sale, gift or some other transaction.

   (c) ***By transmission.*** Here a person becomes a shareholder by transmission of shares to him through death, lunacy or insolvency.

   (d) ***By estoppel.*** This arises when a person holds himself out as a member or knowingly allows his name to remain on the register when he has actually parted with his shares. In the event of winding up, he will be liable, like other genuine members, as a contributory. However, he may escape liability by applying for removal of his name under Section 155.

   (e) ***By agreeing to purchase qualification shares.*** A person who signs and delivers to the Registrar a written undertaking to take from the company and pay for qualification shares is in the same position as if he had subscribed to the memorandum for a similar number. As such, he is also deemed to have become a member automatically on incorporation of the company.

5.7.3 Who may become a Member?

Subject to the provisions of law, the Memorandum and the Articles, any person *sui juris* can become a member of a company. The position of certain person in this regard is given below:

(a) *Minor.* The position of a minor as a member of a company is follows as:

(i) As a minor is wholly incompetent to enter into a contract [Mohri Bibi v. Dharmodas Ghose, (1903) 30 Cal. 539 (P.C)], an agreement by a minor to take shares is void and hence, he cannot be a member of a company.

(ii) If shares are allotted to a minor in response to his application and his name entered on the Register of members, in ignorance of the fact of minority, the company can repudiate the allotment and remove his name from the Register on coming to know of the minority of the member. The company must repay all money received from him in respect of the allotted shares.

(iii) The minor can also repudiate the allotment during his minority and he shall be returned the amount he paid towards the allotment of shares.

(iv) If the name of the minor continues on the register of members and neither party repudiates the allotment, the minor does not incur any liability on the shares during minority and he cannot be held a contributory at the time of winding up [Fazalbhoy Jaffar v. The Credit Bank of India (1914) 39 Bom. 331].

(v) If an application for shares is made by a father as guardian of his minor child and the company registers the shares in the name of the child describing him as a minor, neither the minor nor the guardian can be placed on the list of contributories at the time of winding up [Pahaniappa v. Official Liquidator, Pasupati Bank Ltd., 1942 Mad. 470 and 875].

(vi) If somehow the name of a minor appears on a register of members and in the meantime he attains majority and if he does not want to continue to be a member, then he must repudiate his liability on the shares on the grounds of minority. The company cannot take defence on the principle of estoppel that the minor had fraudulently misrepresented his age or had received dividends and other privileges as a member. However, if he had received dividends and exercised his rights as a member of the company after attaining majority, then he cannot repudiate his liability on shares.

(vii) In case of transfer of a partly-paid shares to a minor, the company may refuse to register him as a member. In case, the company, in ignorance of the minority, has permitted the transfer, then the company may remove the name of the minor and replace it by that of transferor, even though the latter may have been ignorant of the minority.

(viii) In case of fully paid shares, minor's name may be admitted in the register of members, if he happens to acquire the same by way of transfer or transmission. In Devan Singh v. Minerva Films Ltd. (AIR 1956 Punjab 106), the Punjab High Court held that there is no legal bar to a minor becoming a member of a company by acquiring shares (by way of transfer) provided the shares are fully paid-up and no further obligation or liability is attached to them. Similarly, in S.L. Bagree v. Britannia Industries Ltd. (1980), Company Law Board upheld transfer in favour of a minor.

(b) ***Company.*** A company, being an artificial person and a separate legal entity may become a member of another company, if it is so authorised by its memorandum to purchase shares. This is, however, subject to the provisions of Section 42.

Under this section, a subsidiary company cannot be member of its holding company and any allotment or transfer of shares in a holding company to its subsidiary, or even to a nominee for such subsidiary, is void, except that a subsidiary company may:

(i) hold shares in the holding company in the capacity of a personal representative of a deceased shareholder, or (ii) hold such shares as trustees, (except where the holding company or another subsidiary is beneficially interested under the trust otherwise than merely by way of the holding company's business), or (iii) remain a member of its holding company, if it was a member before April 1, 1956, but may not vote at meetings of a holding company or any class of its members.

As has been mentioned earlier, a company cannot purchase its own shares (Section 77) and, therefore, cannot become a member of itself. However, a company may acquire a beneficial interest in its own shares, as by the exercise of its paramount lien on the shares of a member as security for moneys owning by him to the company, or by forfeiture of shares for non-payment of calls.

(c) ***A partnership firm.*** A partnership firm being an unincorporated association and therefore, not having a separate legal entity from the partners, cannot be registered as a member in the register of members of a company. However, partners, either individually or in their joint names (as joint members) may hold shares in a company as a part of the partnership property. But a partnership firm may become a member of a company registered under Section 25 of the Companies Act, 1956 (i.e., associations not for profit).

(d) ***A foreigner.*** As per the Law of Contract, a foreigner can enter into contracts and therefore, can purchase shares in a company but this is subject to the provisions of Foreign Exchange Management Act, 1999 (FEMA).

When the country, of which the foreigner is resident, is at war with India, then the foreigner becomes an alien enemy and therefore, his power of voting at company meetings and his rights to receive notices are suspended during the war-period.

5.7.4 Joint Membership

It is possible for two or more than two persons to hold shares jointly in a company. In that case all of them are not the individual members of the company. Instead, they are said to hold the shares jointly. There is no direct provision for joint membership, but there are a few indirect references.

Therefore, Articles of a company provide for joint membership and sometimes the maximum number of persons who can be joint-holders of shares is given in the Articles (generally not more than four).

Some provisions relating to joint-membership are: (i) Only one share certificate is issued to them (ii) All the members are jointly and severally liable to make payment of calls (Clause 15, Table A). (iii) A person whose name appears first in the order in which the names stands in the register of members, shall be entitled to vote (Clause 57, Table A). (iv) A document may be served by the company on the joint-holders of a share by serving it on the joint-holder named first in the register of members in respect of the share [Section 53(4)]. (v) The names of the joint-holders may be entered in the register of members in the order in which they appear in the Application form or in the Share Transfer Form.

5.7.5 Termination of Membership

A person may cease to be a member of a company when:

(i) he transfers his shares to another person and the shares are registered in the name of the transferee;

(ii) his shares are forfeited by the company for non-payment of calls;

(iii) he surrenders his shares to the company and the latter accepts the surrender;

(iv) his shares are sold by the company to enforce its lien and the buyer of these shares is registered as a member;

(v) he dies and his legal representative gets his own name registered in the register of members or sells shares to a party who gets his name registered with the company;

(vi) he is adjudged insolvent and the Official Receiver/Official Assignee either transfers the shares to a third party who gets registered as a member or disclaims shares;

(vii) he was holder of redeemable preference shares which have now been redeemed by the company;

(viii) he rescinds the contract of membership on the ground of fraud or misrepresentation;

(ix) his shares are purchased either by another member of the company or by the company itself by an order of a Court under Section 402;

(x) he has got share warrants issued in exchange for share certificates of fully paid up shares; and

(xi) on the commencement of winding up (but he will be liable as a contributory and is also entitled to a share in the surplus assets, if any).

As mentioned earlier, a company may be member of another company. In such a situation if the shareholding company is being wound up then the membership will come to an end if the Liquidator disclaims the shares.

5.7.6 Rights of a Member

A member of a company has a number of rights vis-à-vis the company. These are conferred on him either by the Act or by the Articles of the company. Some of the most important rights of a member are:

(i) To have the certificate of shares held ready for delivery to him within three months from the date of allotment;

(ii) To have his name entered in the register of members if it had not been entered or has been wrongly removed;

(iii) To transfer shares subject to the provisions of the Act and the articles;

(iv) To receive notices of meetings, to attend meetings and to vote threat (either in person or by proxy);

(v) To inspect the register of members and register of debenture holders and get extracts therefrom (Section 163);

(vi) To obtain copies of memorandum and articles on request and payment of the prescribed fees;

(vii) To have the first option to buy any new shares on a further issue of shares by the company (Section 81);

(viii) To participate in the election of directors and appointment of auditors;

(ix) To get a copy of the balance sheet and profit and loss account 21 days before the Annual General Meeting;

(x) To apply to the Court to have any "variation of shareholders' rights" set aside (Section 106);

(xi) To obtain, on request, minutes of proceedings at general meetings (Section 196);

(xii) To participate in the removal of directors by passing an ordinary resolution (Section 284);

(xiii) To petition to the Court for prevention of mismanagement and oppression (Section 399);

(xiv) To petition to the Court for an order of injunction restraining the directors from going ahead with an ultra virus act;

(xv) To petition for compulsory winding up;

(xvi) To participate in passing a special resolution for voluntary or compulsory winding up;

(xvii) To participate in the surplus assets, if any, on the liquidation of the company.

5.7.7 Expulsion of a Member

It cannot be denied that there are some members who, by creating various kinds of troubles for the management, try to wrest undue advantage for themselves. Can such members be expelled? The Department of Company affairs following the judgement in the case of Bajaj Auto Ltd. v N.K Furodia [1971] Comp. Cas. 388 have expressed the view that the company cannot by amending the Articles given itself a power to expel a member.

Such an amendment is opposed to the fundamental principles of the Companies' jurisprudence and is ultra vires the company. Such a provision is repugnant to the various provisions in the Act pertaining to the rights of a member in a public limited company and cuts across the scheme of the Act as it has the effect of rendering nugatory the very power of the competent authorities under Section 111 and Section 107 and 5.395 and is, therefore, void by the operation of the provisions of Section 9.

However, it seems permissible for a company limited by guarantee or a company governed by Section 25 to include a provision for expulsion of a member from the company (through forfeiting his shares), if his conduct or action is considered detrimental to the interest of the company.

5.7.8 Liability of Members

A member is also subject to certain liabilities and obligations either by the Act or by the Articles. Some of the important ones are stated hereunder:

1. If shares are not allotted for a consideration other than cash, then a member must pay the whole nominal value of his shares in cash.
2. If a member is holding partly paid-up shares and the company goes into liquidation, then he becomes liable as contributory to pay, if called upon to do so, towards the assets of the company (Section 429).

3. A person may be included in the 'B' list of contributories, as a past member and required to pay to the extent of the amount remaining unpaid on the shares which he held within one year prior to the commencement of winding up, if (i) on the commencement of winding up, debts exist which were incurred while he was a member; and (ii) the contributories of the 'A' list (i.e., present members) are not able to satisfy the contribution required from them in respect of their shares.
4. As mentioned earlier, the liability of members becomes unlimited and several, even in the case of a limited liability company (Section 45).
5. A member is bound to the company by all the covenants of the Articles e.g., a company may have a paramount lien on a member's shares for any amount due from him to the company.
6. In the case of company limited by guarantee, the member may be asked to contribute to the extent of his guarantee at the time of winding up.

5.7.9 Register of Members

Section 150 read with Section 168 requires every company to keep a register of members ordinarily at its registered office. The Register must contain the following particulars: (i) the name, address and occupation of each member; (ii) the number of shares held by each member, distinguishing each share by its number and amount paid-up; (iii) the date of entry in the register, (iv) the date on which a person ceased to be a member.

Where fully paid-up shares have been converted into stock, the fact that stock has been issued is to be entered against the name of the member in the Register.

Index of members. Section 151 requires every company with more than fifty members to keep an Index of Members, unless the Register itself is in the form of an index. The Index of Members is required to be kept at the same place as the Register of Members. The Register of Members is open to inspection by members free of charge and by non-members on payment of one rupee for two hours a day during business hours.

A company may close the Register at any time by giving seven days' previous notice by an advertisement in a newspaper circulating in the district in which the registered office of the company is situated. However, the aggregate number of days for which it can be closed in a year cannot exceed 45 days. Also, it cannot be closed for more than 30 days at a time.

Section 157 provides that a company with a share capital may, if authorised by its articles, keep in any country outside India a branch register of members resident there, called a Foreign Register. The Registrar of Companies must he informed of the place where this Register is kept. The foreign register is a deemed part of the company's principal register and must be kept in the same manner as the principal register.

Rectification of register of members. Section 111 provides for the rectification of the register of members by the Tribunal on an application by any person aggrieved such as member, transferor, transferee, the company. The Company Law Board may order for rectification of the register: (i) where the name of any person is, without sufficient cause, entered in or omitted from the Register of Members of a company; (ii) where default or unnecessary delay occurs in entering on the register the fact that a person has ceased to be a member of the company.

Where the Company Law Board has ordered the rectification of the Register, the rectification should be made and notice of rectification must be filed with the Registrar within 30 days of the order of the Company Law Board.

It is the duty of the company to maintain the register of members. A company cannot take advantage of its failure to maintain the prescribed register of members. Thus, in N. Satyaprasad Rao and others v. V.L.N Sastry & Others [(1988)64 Comp. Cas. 492] was *held* that where register does not incorporate name of all shareholders as members, those shareholders who have been issued share certificates can exercise rights as members.

Check Your Progress

Fill in the blanks:

1. ___ _____ mean a certificate, under the common seal of the company, specifying any shares held by any member.
2. It should be remembered that preference shares are always presumed to be non-participating unless expressly described as_____.
3. No company limited by shares can issue any preference shares which are irredeemable or are redeemable after the expiry of _____from the date of issue.
4. The _____means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available rights in the nature of intellectual property rights or value additions, by whatever named called.
5. _____ _____ ___refers to the transfer of title to shares, voluntarily, by one party to another. _____ means the transfer of title to shares by the operation of law.

5.8 LET US SUM UP

- Section 2(46) defines a share "as a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied".
- A common man uses 'share' and 'share certificate' to mean the same. It is, therefore, important to note the exact differences between the two.
- The share capital of a company is divided into a number of indivisible units of specified amount. A company cannot make an original issue of the stock.
- A company limited by shares may, if authorised by its Articles by a resolution passed in the general meeting, convert all or any of its fully paid-up shares into stock.
- A company may issue all shares with same rights and obligations. However, it may issue different types of shares with different rights and liabilities attached to them so as to satisfy the needs of different types of investors.
- A preference share is one which carries the following two rights over holders of equity shares: (i) a preferential right in respect of dividends at a fixed amount or at a fixed rate and (ii) a preferential right in regards to repayment of capital on winding up.
- Companies are now allowed to issue non-voting equity shares. However, these shares can be issued subject to the rules and conditions prescribed by the Department of Companies Affairs.
- A public company and its subsidiary can issue only two kinds of shares, viz., preference and equity. Therefore, such a company can have only two kinds of

share capital by issue of preference shares and equity shares, viz., prefcrence share capital and equity share capital.

- No company limited by shares and no company limited by guarantee and having a share capital shall have power to buy its own shares, unless the consequent reduction of share capital is effected and sanctioned by the court.
- Companies limited by shares have to issue shares to raise the necessary capital for their operations. Issue of shares may be made in three ways. (i) By private placement of shares; (ii) By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and (iii) By inviting the public to subscribe for shares in the company through a prospectus.
- Transfer of shares refers to the transfer of title to shares, voluntarily, by one party to another. Transmission of shares means the transfer of title to shares by the operation of law.
- A transmission of interest in shares of a company, of a deceased member of the company, made by the legal representative of a deceased member shall be considered as transmission of shares by operation of law. This transmission will be registered by a company in the Register of Members.
- The 'certification of transfer' and the 'balance ticket' are exchanged for share certificates as and when they are ready. In case of shares being sold to two or more transferees, the certification of transfers is exchanged for the new certificates.
- In the case of a company, limited by shares, the persons whose names are put on the register of members are the members of the company. They may also be called shareholders of the company as they have been allotted shares and are holding them in their own right.

5.9 LESSON END ACTIVITY

A public company limited by shares forfeited one hundred equity shares held by a defaulting member and reissued them to another person, making a profit of ₹20,000. But no return of allotment was made as regards to these one hundred shares so re-issued. Discuss with your classmates whether the company has contravened any provisions of the Companies Act, 1956.

5.10 KEYWORDS

Share: A share is a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied.

Preference Share: A preference share is one which carries a preferential right in respect of dividends at a fixed amount or at a fixed rate, and regard to repayment of capital on dividing up.

Underwriting: It consists of an undertaking by a person that if the public fails to take up the issue, he will do so.

Perpetual Succession: Perpetual succession is the continuation of a corporation's or other organization's existence despite the death, bankruptcy, insanity, change in membership or an exit from the business of any owner or member, or any transfer of stock, etc.

Probate: If a member of a company dies and he leaves after him a will or letter of administration then the survivors shall get a copy of 'will' certified under the seal of a Court of competent jurisdiction. The certified copy of the will is called a 'probate'.

Member: He is the person who agrees in writing to become a member of a company and whose name is entered in the register of members.

Forfeiture of Share: It means removing the name of a member from the register of members after following the prescribed procedure as given in the articles and the act.

Lien on Shares: It is an equitable charge on shares to secure any debt which may be due from the member of the company.

Surrender of Shares: It means voluntary return of shares by a shareholder to the company for their cancellation.

5.11 QUESTIONS FOR DISCUSSION

1. Define 'share' and 'stock' and distinguish between the two.
2. Write a short note on the following: (i) Issue of shares at premium (ii) Issue of shares at discount.
3. Describe the procedure for alteration of share capital.
4. Describe the procedure for reduction of share capital.
5. Write short notes on: (i) Right shares (ii) Bonus shares.
6. A company limited by shares intends to buy some of its own shares. Advise.
7. Explain the provisions regarding the increase of the subscribed capital by a public company by allotment of further shares.
8. How is membership of a company acquired? Distinguish between a member and a shareholder.
9. How does one cease to be a member of a company?
10. Distinguish between transfer and transmission of shares

Check Your Progress: Model Answer

1. Share certificate
2. Participating
3. Ten years
4. Sweat equity shares
5. Transfer of shares, Transmission of shares

5.12 SUGGESTED READINGS

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LESSON

6

DEBENTURES

CONTENTS

6.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Discuss the meaning of debenture, rules relating to debentures, debenture stock, issue of debentures and Debenture Redemption Reserve (DRR)

- Explain the remedies and features of debenture holders
- Identify the types of debentures
- Recognize the advantages/merits of debentures and disadvantages/demerits of debentures
- Discuss about charge
- Elucidate the borrowing power of company

6.1 INTRODUCTION

Debentures are an important source of long-term finance. Raising of funds by issue of debentures is allowed to public limited companies, if Memorandum of Association is (MoA) permitted.

Creditorship securities are those securities, which are issued to creditors for raising finance. The securities are debentures/bonds. The amount raised by issue of debentures/bonds is known as debt capital Debenture and bond capital is one of the cheapest sources of long term finance.

A debenture and bond is an acknowledgement given by the firm for having received a sum of amount as debt. Here, there is no need to understand the two terms debenture and bond. Debenture and bond, both are issued by a corporate concern to raise long-term capital, but there is a difference between them.

The term bond refers a security that has been secured by tangible fixed assets of a corporate, and debentures are not secured, (i.e., they are secured by credit worthiness of a corporate and not by assets). In US, the debt securities are called as bonds. In India and UK, the securities are called as debentures, and they are treated as synonym. Hence, in the following discussion, the two terms debenture and bond have been used interchangeably.

6.2 MEANING OF DEBENTURE

The term 'Debenture' is derived from the Latin word 'debere', which means 'to be a debtor'. As per Section 2(12) of Companies Act 1956, "Debenture includes debenture stock, bond and any other securities of the company whether constituting a charge on the company's assets or not". It is not clear or does not explain fully what is debenture.

According to *Naidu and Datta*, "a debenture is an instrument issued by the company under its common seal acknowledging a debt and setting forth the terms under which they are issued and are to be paid".

A person who buys debentures is debenture holder and creditor of the company. Debenture can be priced in the same manner as share. In other words, they can be issued at face (par) value, at premium or at a discount.

A Debenture is a unit of loan amount. When a company intends to raise the loan amount from the public it issues debentures. A person holding debenture or debentures is called a debenture holder.

A debenture is a document issued under the seal of the company. It is an acknowledgment of the loan received by the company equal to the nominal value of the debenture. It bears the date of redemption and rate and mode of payment of interest. A debenture holder is the creditor of the company.

A Company may create one loan fund known as 'debenture stock' divisible among a class of lenders each given a debenture stock certificate. It is analogous to loan stocks of governments, local and public authorities.

6.2.1 Rules Relating to Debentures

Under various sections of the Companies Act, 1956, various important rules are provided relating to debenture which are mentioned below –

(i) Under Section 117, no debenture holder is to have any voting rights in company meetings. This applies to debentures issued after the commencement of the Act of 1956.

(ii) Under Section 118, if there is a trust deed securing the issue of debentures, every debenture holder can have a copy of it on payment of a small fee.

(iii) Under Section 119, the trustees in a trust deed securing the issue of debenture must exercise due care and diligence in the performance of their duties. Any provision in the deed exempting them from liability on this account is void.

(iv) Under Section 120, debenture may be irredeemable or redeemable on the happening of a contingency.

(v) Under Section 121, redeemed debentures can be reissued unless there is any provision to the contrary, whether express or implied in the articles or in the conditions of the issue of the debentures or in any contract entered into by the company or when the company has passed a resolution to that effect.

(vi) Under Section 122, an agreement to take a debenture can be specifically enforced.

(vii) Under Section 123, debts of the company shall have priority over the claim of the shareholders, which by the act receive preferential payment in case of winding up.

(viii) Under Section 128, full particulars regarding the issue of debenture in series must be sent to the Registrar of Companies

(ix) Under Section 129, the particulars must include a statement of the commission paid.

(x) Under Section 482, there are certain limits on the amount of commission and brokerage that can be paid for the sale of debenture.

(xi) Under Section 108-113, necessary rules pertaining to the transfer of debentures and share certificates are provided.

(xii) Under Section 152(1) every company shall keep a register of debenture holders entering therein particulars regarding the name, address and occupation of the debenture holders and dates on which the holding commenced or ceased.

(xiii) Under Section 152(2) every company having more than 50 debenture holders shall keep an index of debenture holders unless the register of debenture holders is itself kept in the form of an index.

(xiv) Under Section 153, no notice of any trust express or implied or constructive shall be entered in the register of debenture holders.

(xv) Under Section 154, the register of debenture holders may be closed for not more than 45 days in the year and not more than 30 days at a time by giving atleast 7 days notice through a local newspaper.

(xvi) Under Section 157 and 158, there may be a foreign register of debenture holders analogous to the foreign register of members.

6.2.2 Debenture Stock

A company instead of issuing individual debentures, evidencing separate and distinct debts, may create one loan fund known as "debenture stock" divisible among a class of lenders each of whom is given a debentures stock certificate evidencing the parts of the whole loan to which he is entitled.

Thus debenture stock, which is analogous to the loan stocks of governments and local and public authorities, is then the indebtedness itself and the certificate evidences the stockholder's interest in it. A consequence of the distinction is that whereas a debenture is a single thing which can be legally transferred only as one entity, debenture stock can be sub-divided and transferred in any fractions which the holder wishes. Further, "debenture stock" must be fully paid; debenture may or may not be fully paid. However, for the purpose of the Companies Act, 'debenture' includes 'debenture stock'.

6.2.3 Issue of Debentures

Debentures are commonly issued in a similar manner as shares by means of a prospectus inviting applications, the money being usually payable by installments on application, allotment and on specified dates. The power to issue debentures rests with the Board of Directors (Section 292) Debentures may be issued at par, at a premium or at a discount, unless the Articles specifically forbids issue of debentures at a discount.

The company must complete and keep ready for delivery the debenture certificates within 3 months of allotment, unless the terms of the issue provide a longer period (Section 113).

6.2.4 Debenture Redemption Reserve (DRR)

Section 117C provides that a company is required to create DRR for the redemption of any debentures issued after 2000. The company shall credit the DRR with adequate amount from out of its profits every year until such debentures are redeemed.

DRR can be utilized by the company only for the purpose of redemption of debentures and no other purpose.

If a company fails to redeem the debentures on the due date, any or all the debenture holders can make an application to Company Law Board. The Company Law Board, after hearing the parties concerned, may direct by order, the company to redeem the debentures forthwith by payment of principal and interest due thereon.

If default is made in complying with the provisions of Section 117C, then every officer of the company who is in default shall be punishable with imprisonment which may extend to 3 years and shall also be liable to fine which shall not be less than ₹500 for every day during which the default continues.

6.2.5 Remedies of Debentureholders

In case of default by the company in repayment, the remedies of a debenture holder vary according to whether he is secured or unsecured.

An unsecured debenture holder is in exactly the same position as a creditor and he has the same remedies. Thus, (1) he may sue for the principal and interest; or (2) he may present a petition for the winding up of the company and prove his debt as unsecured creditor.

A secured debenture holder has both the above remedies, but in addition he has the following courses also open to him:

I. ***Where a trust deed has been executed***

1. ***Sale of assets.*** The power of sale by trustees is one of the express powers usually contained in the debenture or debenture trust deed. If no such power is given, an application may be made to the Court for an order to sell.

2. ***Foreclosure.*** The trustees may make an application to the Court for an order of foreclosure, the effect of which is that the borrowers' interest in the assets charged is completely extinguished and the lender becomes the owner of them. For an action of foreclosure, it is necessary that all debentureholders of the class concerned join hands [*Wallance v. Evershed (1899) 1 Ch. 891*].

3. ***Appointment of a receiver.*** Where there is a trust deed, it often provides that the trustees may appoint a receiver. If no such power is given, application to appoint one may be made to the Court in a debentureholders' action. On the appointment of a Receiver, the assets become specifically charged in favour of the debentureholders and the power of the company to deal with them in the ordinary course of business ceases, although the company continues to exist until it is wound up.

II. ***Where no deed has been executed***

Debentureholders' action. Where no trust deed had been executed in favour of debentureholders, a debentureholder may, on default in payment of principal or interest, bring an action (called a debentureholders' action) on behalf of himself and other debentureholders of the same class asking for: (i) a declaration that the debentures have a charge on the assets; (ii) an account of what is owed to the debentureholders; the amount of assets; prior claims, etc.; (iii) an order of foreclosure or sale; (iv) the appointment of a receiver.

If a debentureholder owes a debt to the company which is insolvent, the holder cannot set off his debt against the liability he owes to the company. The rule is that a person who claims a share in a fund must first pay up everything he owes to the fund before he can claim a share [Re Borwn and Gregory Ltd. (1904) 1 Ch.627].

SEBI has also issued guidelines for disclosure and investor protection pertaining to debentures.

6.3 FEATURES OF DEBENTURES

The features of debentures are as follows:

1. ***Fixed Rate of Interest:*** In general the debentures are issued at a fixed rate of interest, but they may also be issued at a floating rate of interest or a zero interest. The fixed rate debentures are more popular in India. The rate of interest is on face value of the debenture that will be paid out annually or semi-annually. The interest payable on debentures is tax deducible. Company is free to determine the interest rate, which may be fixed or floated.

2. ***Maturity:*** The debenture capital is the cheapest source of long-term finance, but it should be repaid after a specific period. In other words, debentures are issued for a specific period (i.e., 10 years or 5 years debentures). The period in which the debentures are issued or the period after which the debenture capital is repaid is known as maturity period. The maturity period may vary between 1 year to 20 years. In India, non-convertible debentures are redeemed after 7-10 years.

3. ***Redemption:*** Debentures can be repaid either in installment wise or lump sum. If it is repaid in one lump sum amount, it can be done by creation of debenture redemption reserve. It is compulsory for all debentures whose maturity period exceeds 18 months. Company should create Dividend Redemption Reserve (DRR) equivalent to atleast 50 percent of the amount of issue before commencement of repayment.

4. ***Call and Put Option:*** Debentures may have 'call' option, which gives the right to 'buy' to issuing company at a certain price before the maturity period. The buyback (call) price may be more than the face value of debenture generally 5 percent, which is known as premium on redemption. Sometimes, debentures may also put an option, which gives a right to the debenture holder to seek redemption at specified times and at pre-decided prices.

5. ***Debenture Indenture:*** A debenture indenture is a legal document, which specifies the rights of both the issuing company and the debenture holder. The debenture indenture includes descriptions of the amount and timing of the interest and principle amount payments (installments or lump sum), various standard and restrictive provisions, and frequently sinking fund requirements and security interest provisions. The indenture gives the responsibility to the trustee to protect the interest of debenture holders by fulfilling the above stated descriptions.

6. ***Security Interest:*** Debenture may be either secured or insecure. In India most of the debenture is secured debentures. A secured debenture is a debenture which is secured by a charge on the company's immovable assets and a floating charge on other assets. An unsecured debenture is one which is without any charge on firm assets, these are known as naked debenture.

7. ***Convertibility:*** Companies can also issue convertible debentures. It is the debenture that is convertible into equity shares at the option of the debenture holder. The conversion ratio and the period during which conversion can be affected are specified at the time of issue of debentures.

8. ***Credit Ratings:*** Before issue of debentures to the public, the issuing company needs to get the debentures rated by anyone of the credit rating agencies. The four credit rating agencies are:

   Credit Rating Information Services of India Limited (CRISIL), Investment Information and Credit Rating Agency of India Limited (ICRA), Credit Analysis and Research Limited (CARL), FITCH India and Duff & Phelps Credit Rating India Pvt. Ltd (DCRI).

9. ***Claim on Income and Assets:*** Debenture interest is tax deductible. In other words, debenture interest is paid from Earnings before Interest and Taxes (EBIT) or operating profit. The interest is payable before payment of tax, preference dividend and equity dividend. So, debenture holders have priority of claim on income. At the same time they also have priority of claim on company assets at the time of winding up. Failure of interest forces to bankruptcy.

6.4 TYPES OF DEBENTURES

The following are the different types of debentures:

1. From the redemption point of view, the debentures are sub-divided into two:

   (a) *Redeemable Debenture:* These debentures are issued by the company for a specific period only. Redeemable debentures are those debentures, which are to be repaid by the company at the end of specified period or within the specified period at the option of the company by giving a notice to debenture

holders with the intention to redeem debentures either lump sum or installments. On the expiry of period, debenture capital is redeemed or paid back. Generally the company creates a special reserve account known as "Debenture Redemption Reserve Fund" for the redemption of such debentures. The company makes the payment of interest regularly. Under section 121 of the Indian Companies Act, 1956, redeemed debentures can be re-issued.

(b) *Irredeemable Debenture:* Irredeemable debentures that are not redeemable during the existence (life) of the company. These debentures are issued for an indefinite period. They are repayable either if the company fails to pay interest on them or at the time of liquidation of the company. These types of debentures are also known as perpetual debentures. The debenture capital is repaid either at the option of the company by giving prior notice to that effect or at the winding up of the company. The interest is regularly paid on these debentures. The principal amount is repayable only at the time of winding up of the company. However, the company may decide to repay the principal amount during its lifetime.

2. From the conversion point of view, the debentures are sub divided into two:

(a) *Convertible Debenture:* Convertible debentures are those debentures that are convertible into equity shares at the option of the debenture holders after stating period at a predetermined price. If the holders exercise the right of conversion, they cease to be the lender to the company and become the members. The rate of exchange of debentures into shares is also decided at the time of issue of debentures. Interest is paid on such debentures till its conversion. Prior approval of the shareholders is necessary for the issue of convertible debentures. It also requires sanction of the Central Government. The debenture capital may be Fully Convertible Debentures (FCDs) or Partially Convertible Debentures (PCDs). This type of debentures is attractive, even though they carry a low rate of interest when compared to non-convertible debentures.

(b) *Non-convertible Debenture:* As the name itself, suggests that the debenture does not carry the option of conversion into equity. These are those debentures which cannot be converted either into equity shares or preference shares. They may be secured or unsecured. Non-convertible debentures are normally redeemed on maturity period which may be 10 or 20 years.

3. From the security point of view, the debentures are sub-divided into two:

(a) *Secured or Mortgaged Debenture:* Secured or Mortgaged debentures are those debentures that are issued with a charge on the immovable assets of the company. These are those debentures which are secured against the assets of the company which means if the company is closing down its business, the assets will be sold and the debenture holders will be paid their money. The charge may be fixed or floating or on particular assets. In case of failure in payment of interest or principle amount, debenture holders can sell the assets in order to satisfy their claims. In case of fixed charge, the charge is created on a particular asset such as plant, machinery, etc. These assets can be utilised for payment in case of default. In case of floating charge, the charge is created on the general assets of the company.

(b) *Necked or Simple or Unsecured Debenture:* Necked debentures do not carry any charge on company's assets as regards to the payment of interest and repayment of principle amount. But being creditors of the company, they have general charge on the assets of the company. These are those debentures

which are not secured against the assets of the company which means when the company is closing down its business; the assets will not be sold to pay off the debenture holders. These debentures do not create any charge on the assets of the company.

There is no security for repayment of principal amount and payment of interest. The only security available to such debenture holders is the general solvency of the company. Therefore, the position of these debenture holders at the times of winding up of the company will be like that of unsecured debentures. That is they are considered with the ordinary creditors of the company.

4. From the transfer or registration point of view, the debentures are sub-divided into two:

   (a) *Registered Debenture:* Registered debentures are those debentures that are registered with the issuing company. Names, addresses and other particulars of holders are recorded in debenture register, which is kept by the issuing company. Transfer of this type of debentures needs a regular transfer deed, at the time of transfer of such debentures. The interest is paid only to the person on whose name the debenture is registered.

   (b) *Bearer Debenture:* Bearer debentures are those debentures that are payable to the bearer and transferable by delivery only. Bearer debentures are negotiable instruments and the company keeps no records for them. The interest is paid to the bearer of debenture.

5. Other types of Debentures

   (a) *Zero Interest (Coupon) Debentures (ZID): Zero interest (coupon)* debentures are of the innovative debt instruments. This type of debenture does not carry any interest (coupon) rate. Generally, they are issued at a discount from their maturity/redeemable value. The return for the holders of this type of debenture is the difference between purchase (issue) price and maturity (redeemable) value. For example, Mr. A has purchased a debenture at ₹50, having a maturity period of 10 years, and debenture redeemable value is ₹200. Hence, the return to holder is ₹150 (₹200 - ₹50).

   (b) *Deep Discount Debenture/Bond (DDB):* Deep discount bond is the same as zero coupon bond but deep discount bond is issued at a deep discount from its redeemable (maturity) value. In India, DDBs are being issued by the public financial institutions. They are Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI), etc.

   For example in the year 1992 IDBI sold deep discount bonds at deep discount price of ₹2,700, with maturity value of ₹1 lakh and its maturity period is 25 years. It was the first institution to issue DDB. DDBs enable the issuing company to consume cash during maturity period. In other words, the issuing company need not serve the debt by paying interest. It reduces the risk of reinvestment of interest, which is receivable at the end of every year. However, DDBs exposed to high risk since the entail a balloon payment at the end of maturity period.

   (c) *Floating Rate Bonds (FRBs):* Floating rate bonds are those bonds in which the rate of interest is not fixed. The interest rate is floating and its linked interest rate on Treasury Bills (TBs), Bank Rate (BR), which are considered as benchmark. In India, State Bank of India (SBI) was the one of earliest financial institution to successfully sell floating rate bonds. Later, IDBI also

issued this type of debentures. Floating rate bonds provide protection against inflation risk to investors or bondholders.

(d) *Secured Premium Notes (SPNs):* SPN is a type secured debenture redeemable at a premium over the face or purchase price. It is like zero interest debenture, since there will be no interest payment in the lock-in-period. SPN holders have the option to sell back the debenture/note to the issuing firm at face value after the given lock-in-period. SPNs are tradable instruments. *For example, Tata Iron & Steel Company (TISCO) issued this type of notes in 1992, face value of ₹300. No interest would accrue during the first year after allotment. During 4-7 years the principle amount will be repaid in installments of ₹75, in addition ₹75 in each year as interest and redemption on premium. The buyer was given an option to sell back SPNs at the ₹300.*

(e) *Guaranteed Debentures:* These are the one type of debentures on which the payment of interest and principle amount is guaranteed by third party at the time of their issue. The third parties are financial institutions, government, etc.

(f) *Callable Bonds:* Callable bonds are those bonds that can be called in and purchased at a price. Companies generally call back bonds only when the interest rates fall in the market less than the bond's interest rate. Companies redeem high interest bonds and raise funds by issue of low interest bonds. IDBI was the first bank to issue bonds with call features in 1992.

6.5 ADVANTAGES/MERITS OF DEBENTURES

The advantages of debentures may be studied under two heads:

1. Advantages/Merits to Company:

   (a) Debenture capital is one of the cheapest sources of long-term finance, since interest payment on debentures is a tax-deductible expenditure and low flotation cost.

   (b) Issue of debenture does not dilute control, since they do not entitled voting right.

   (c) Debentures enable the company to take advantage of trading on equity, which results shareholders wealth maximization.

   (d) Debenture capital provides flexibility in capital structure, if they are issued as redeemable or if not also, since they have call option.

   (e) Debenture holders does not participate in the surplus profits of the company since, payments to them are limited to interest and principle amount.

   (f) Debenture capital provides protection against inflation since, the interest rate is fixed.

2. Advantages/Merits to Debenture holders:

   (a) Debentures provide a fixed, regular and stable source of income.

   (b) Debenture holders' investment is safe and secured since, debentures with a charge on company is assets.

   (c) Debentures are issued for a definite maturity period.

   (d) Debentures holders' interests (payment of interest and principle amount) are protected by the debenture indenture.

6.6 DISADVANTAGES/DEMERITS OF DEBENTURES

The following are the important disadvantages of debentures:

1. Disadvantages/Demerits to Company:
   (a) Raising debenture capital is risky one, since it involves payment of fixed interest charges and repayment of principle amount, which are legal obligations of the issuing company failure to (pay) honour, it may lead to bankruptcy.
   (b) Raising debenture capital increases financial leverage (risk perception on investors), which raise the cost of equity according to Capital Assets Pricing Model (CAPM) of the company.
   (c) Raising debenture capital involves restrictions, like limit the borrowing, limit dividend payment, etc.
   (d) Debenture (irredeemable) capital is costly one, when the rate of inflation decreases. Since the interest rate comes down in the market.
   (e) This is not stable source of long-term finance for a firm with variable earnings.
2. Disadvantages/Demerits to Debenture holders':
   (a) Debentures do not carry any voting rights, which give no controlling power on the working of the company.
   (b) Debenture holders' docs not have claim on surplus profits since they are not the owners of the company.
   (c) Receipt of debentures is fully taxable under the head income from other sources.
   (d) Debenture holders' loose interest charges, if the inflation increases.
   (e) Debenture prices are vulnerable with changes interest rates.

6.7 MORTGAGES

A mortgage is a legal process whereby a person borrows money from another person and secures the repayment of the borrowed money and also the payment of interest at the agreed rate. by creating a right or charge in favour of the lender on his movable and/or immovable property.

Mortgage as defined in Transfer of Proprty Act, 1882

According to Section 58 of the Transfer of Property Act, a mortgage is the transfer of an interest in specific immovable property for the purpose of securing the payment of money advanced or to be advanced by way of loan, an existing or future debt, or the performance of an engagement which may give rise to pecuniary liability.

The transferor is called the 'mortgagor' and the transferee a 'mortgagee' the principal money and interest of which payment is secured is called mortgage money and the instrument by which the transfer is effected is called the 'mortgage deed'.

(a) Ingredients of Mortgage

From the above definition of mortgage, the following are the requirements of a mortgage:

(i) There should be transfer of interest in the property by the mortgagor (the owner or lessor).

(ii) The transfer should be to secure the money paid or to be paid by way of loan.

(b) Various Types of Mortgage

The Transfer of Property Act contemplates six different kinds of mortgages. They are:

(i) Simple mortgage

(ii) Mortgage by conditional sale

(iii) Usufructuary mortgage

(iv) English mortgage

(v) Mortgage by deposit of title deeds (Equitable mortgage)

(vi) Anomalous mortgage

(c) Charge and Mortgage Distinguished

There is a clear distinction between a mortgage and a charge, the former being a transfer of an interest in immoveable property as a security for the loan whereas the latter is not a transfer, though it is nonetheless a security for the payment of an amount.

A mortgage deed includes every instrument whereby for the purpose of securing money advanced, or to be advanced, by way of loan, or an existing or future debt, one person transfers, or creates in favour of another, a right over a specified property.

6.8 CHARGE

Charge denotes an impediment over the title of the property, i.e., when the charge is created on an asset, the asset is not allowed to be sold or transferred. Basically, there are three ways through which charge is created on the property, that are classified according to the movability of the asset, i.e. On movable property, the charge is created by way of pledge or hypothecation, whereas when the charge is created on an immovable asset, then it is known as Mortgage.

The basic purpose of creating a charge is to gain financial assistance from the lending institution. There are many students, who juxtapose charge and mortgage, but they are different. The former is just a collateral for the payment of the amount due, whereas the latter is the transfer of interest in the asset, as collateral.

The assets which are available with the company at present as well as the assets in future are charged for the purpose. A mortgage deed is executed by the company. The deed includes the term of repayment, rate of interest, nature and value of security, dates of payment of interest, right of debenture holders in case of default in payment by the company. The deed may give a right to the debenture holder to nominate a director as one of the Board of Directors. If the company fails to pay the principal amount and the interest thereon, they have the right to recover the same from the assets mortgaged.

6.8.1 Fixed and Floating Charges

Fixed charge is a charge on definite or specific property, i.e., the charge attaches to the property that is identified at the time when the charge is created, e.g., land, heavy machinery, buildings. The essence of fixed charge is that though the possession of the specified asset is with the company but the legal title belongs to the holders of the charge.

The consequence of this charge is that the company cannot dispose of that asset, free of charge, without the consent of the holders of the charge. Even if it is disposed of, the holders of the charge will have the first claim as against the buyer of the property.

If company creates a fixed charge on stock in trade, company will not be able to deal in that. This would limit the company's powers to borrow. Hence a floating charge, is generally, created on assets such as stock-in-trade.

Floating charge, on the other hand, is not attached to definite property but covers property of a fluctuating type, e.g., stock-in-trade. The characteristics of a floating charge are: (1) It is a charge on a class of assets, present and future; (2) The class of assets charged is one which in the ordinary course of business, is changing from time to time; (3) Until some steps are taken to enforce the charge, the company may continue to deal with the assets charged in the ordinary course of business.

No particular form of words is necessary to create a floating charge. Any words which show an intention to allow the company to continue to deal with the assets by sale, lease, mortgage, etc., in the course of its business will create a floating charge. The advantage, of such charge is that the company may continue to deal with the property charged.

Whether a charge is a fixed charge or a floating charge will depend upon the words used in the document creating the charge; the essence of floating charge being the freedom of the borrower to use the assets charged, in the ordinary course of its business. It can even create a specific mortgage of the property, already subject to a floating charge, without the consent of the holders of the charge and the registered mortgagee shall have priority over the charge [*Wheatley v. Silkstone Co. (1885) 29Ch. D.715*]. But a company cannot, however, create a further floating charge on the same assets to rank in priority to or pari passu with the existing charge unless such power has been reserved by the company [Re Benjamin Cope & Sons (1914) 1 Ch. 800)]. Before crystallisation of the floating charge a company may even sell the whole of the undertaking if that is one of the object specified in the memorandum [Re Borax Co. (1901) 1 Ch. 326]. Where, however, a specific charge is made expressly subject to floating charge, the former is postponed as from the date when the later is crystallised [Re Robert Stephenson & Co. Ltd. (1913) 107 L.T. 33].

A floating charge can be created only by an incorporated body. It is created by a deed and most be registered with the Registrar.

Crystallisation of a floating charge. A floating charge crystallises and becomes fixed in the following circumstances: (1) When the company goes into liquidation; or (2) When the company ceases to carry on business; or (3) When the debenture holders take steps to enforce their security, e.g., by appointing a receiver, etc., on default by the company to pay principal and interest.

Effects of winding up on floating charge. (A) According to Section 123, the debts, which are entitled to a preferential payment in the event of the winding up of a company under Section 530, get priority over the claims of the debenture holders having a floating charge, even though the company is not in the course of winding up. (B) Where company is being wound up, a floating charge on the undertaking or property of the company created within 12 months immediately preceding the commencement of the winding up shall be void unless: (1) The company was solvent immediately after the charge was created; and (2) The amount was paid to the company in cash at the time of or subsequently to the creation of and in consideration for, the charge together with interest on that amount at the rate of 5% per annum or such other rate as prescribed by the Central Government.

The object of the above provision is to prohibit insolvent companies from creating any floating charge on their assets with a view to secure past debts to the prejudice of unsecured creditors.

6.8.2 Registration of Charges (Section 125)

Section 125 requires that the following charges must be registered with the Registrar within 30 days after the date of their creation; (i) a charge for the purpose of securing any issue of debentures; (ii) a charge on uncalled share capital of the company; (iii) a charge on any immovable property; (iv) a charge on any book debts of the company; (v) a charge not being a pledge on any movable property of the company; (vi) a floating charge on the undertaking or any property of the company including stock in trade; (vii) a charge on calls made but not paid; (viii) a charge on a ship or any share in a ship; (ix) a charge on goodwill, or a patent or a licence under a patent, or a trade mark or a licence under a trade mark; or a copyright or a licence under a copyright.

The Registrar may, however, allow the registration of a charge within 30 days next following the expiry of the said period of 30 days on payment of specified additional fee, if the company satisfies the Registrar that it had sufficient cause for not filing the required particulars or instrument, etc., within that period.

It is the duty of the company to send the above particulars to the Registrar but registration may also be effected on the application of the creditor. The creditor may in such a case recover the registration fee from the company (Section 134).

Effect of non-registration

1. In case a registrable charge is not registered within the prescribed time, it becomes void (i) against the liquidator; and (ii) any creditor of the company. However, the charge shall not be void against a purchaser of the properties charged [State Bank of India v. Vishwanirayat (P) Ltd. (1987) 3 Comp. L.J. 171].
2. However, the debt, in respect of which the charge was given remains valid, that is, it can always be recovered as an unsecured debt.
3. Another effect of non-registration of a charge is that the money secured thereby becomes immediately payable.

Besides, company and every officer may be subjected to a penalty upto ₹500 for every day during which the default continues.

6.8.3 Miscellaneous Provisions as Regards Charges

1. ***Date of notice of charge (Section 126).*** Where any charge on any property of a company required to be registered under Section 125 has been so registered, any person acquiring such property or any part thereof or any share of interest therein shall be deemed to have notice of the charge as from the date of such registration.
2. ***Register of charges to be kept by registrar (Section 130).*** The Registrar shall with respect to each company cause to be kept a register containing all the charges requiring registration and shall on payment of the prescribed fee, cause to enter in the Register with respect to every such charge the following particulars: (i) the date of its creation; (ii) the amount secured by the charge; (iii) short particulars of the property charged; and (iv) the persons entitled to the charge.

   In case of a charge to the benefit of which the holders of a series of debentures are entitled, the particulars to be entered in the Register are: (i) the total amount secured by the whole series; (ii) the dates of the resolutions authorising the issue of the series and the date of the covering deed, if any, by which the security is created or defined; (iii) a general description of the property charged; (iv) the names of the trustee, if any, for the debentureholders; and (v) the amount or rate percent of the commission or discount; if any, paid to any person subscribing or procuring subscriptions for any debentures of the company (Sections.128 and 129).

The Register so kept shall be open to inspection by any person on payment of a fee of one rupee for each inspection.

3. ***Index to Register of Charges (Section 131).*** The Registrar shall give a certificate under his hand of the registration of any charge registered with him stating the amount thereby secured. The certificate shall be conclusive evidence that the requirements of the Act as to registration have been complied with.

4. ***Modification of Charges (Section 135).*** Section 135 provides that whenever the terms or conditions, or the extent and operation, of any charge registered are modified, it shall be the duty of the company to send to the Registrar the particulars of such modification within 30 days.

   It may be noted that under Section 134, a charge can be filed by the company or by any person interested in the charge. However, under Section 135, modification of a charge can only be filed by the company.

5. ***What Constitutes Modification.*** The term 'modification' includes variation of any of the terms of the agreement including variation of rate of interest which may be by mutual agreement or by operation of law. Even if the rights of a charge holder are assigned to a third party, it will be regarded as a modification. Likewise, partial release of the charge on a particular asset or property, shall amount to modification of the charge.

6. ***The memorandum of satisfaction (Sections 138 to 140).*** On payment or satisfaction of any charge, in full, the company must notify the fact to the Registrar within 30 days from the date of such payment or satisfaction. The Registrar shall, on receipt of such intimation cause a notice to be sent to the holder of the charge calling upon to show cause within a time specified in such notice (but not exceeding 14 days) as to why payment or satisfaction should not be recorded as intimated to the Registrar. If no cause is shown, the Registrar shall order that a memorandum of satisfaction shall be entered in the Register of Charges.

   But if cause is shown, the Registrar shall record a note to that effect in the Register and shall inform the company that he has done so. The Registrar may also record memorandum of satisfaction even if no intimation has been received by him from the company on getting evidence to his satisfaction that any registered charge has been satisfied in whole or in part.

   Where the Registrar enters a memorandum of satisfaction as above, he shall furnish the company with a copy of the memorandum of satisfaction (Section 140).

7. ***Rectification of register of charges by Central Government (Section 141).*** The Central Government is empowered to extend time for the registration of the charge or to order that the omission or misstatement in the Register of Charges be rectified. The persons who may apply to the Central Government for such an order are the company or any interested person. The Central Government has to be satisfied that the failure to register the charge or the omission or misstatement: (a) was accidental; or (b) was due to inadvertence or some other sufficient cause; or (c) is not of a nature as to prejudice the position of creditors or shareholders of the company; or (d) that on other grounds it is just and equitable to grant relief.

   Where the Central Government extends the time for the registration of a charge, the order shall not prejudice any rights acquired in respect of the property concerned before the charge is actually registered.

8. ***Company's register of charges (Section 143).*** Every company must keep at its registered office a Register of Charges and enter therein all charges specifically affecting property of the company and all floating charges on the undertaking or on any property of the company, giving in each case: (a) a short description of the property charged; (b) the amount of the charge; and (c) the names of the persons entitled to charge.

If any officer of the company knowingly omits or wilfully authorises or permits the omission of any of the above entries, he shall be punishable with fine which may extend to ₹5,000.

Effects of Registration: Once a charge is registered, it acts as a notice to the public at large that the charge holder has an interest in the charged property. No person can take a defense against the charge holder that he was not aware that a charge was created against the property. That person will be entitled to the property subject to the interest of the charge holder. Once certificate of charge is issued by the Registrar, it is conclusive evidence that the document creating the charge is properly registered.

Modification of Charge: Wherever the terms and conditions or the extent of the operation of any registered charge is modified, the company is required to file the particulars of modification within 30 days thereof with the Registrar of Companies.

Particulars to be filed with registrar:

(i) Date and description of investment creating charge.

(ii) Amount secured by charge.

(iii) Particulars of property charged.

(iv) Terms and conditions and extent of operation of charge.

(v) Name, address and description of investment modifying the charges.

(vi) Particulars of modification.

Government Stock and Investment Company v. Manila Railway Company

In Government Stock Investment Co. Ltd. v. Manila Railway Co. Ltd., (1897) A.C. 81, the debentures created a floating charge. Three months' interest became due but the debenture holders took no steps and so the charge did not crystallize but remained floating. The company then made a mortgage of a specific part of its property. Held, the mortgagee had priority. The security for the debentures remained merely a floating security as the debenture holders had taken no steps to enforce their security.

6.9 BORROWING POWER OF COMPANY

Every trading company has an implied power to borrow but it is wise to include an express power to borrow in the objects clause of the memorandum. Non-trading companies, however, must be expressly authorised to borrow by their memorandum.

A power to borrow, whether express or implied, includes the power to charge the assets of the company by way of security to the lender.

The Companies Act does not expressly empower companies to borrow money. Therefore, most of the companies expressly provide for such borrowing powers in the memorandum. In such cases, where memorandum authorises the company to borrow, the Articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum amount which can be borrowed by the company.

Exercise of borrowing powers. A public company cannot exercise its borrowing powers until it secures the certificate to commence business [Section 149 (1)]. A

private company may, however, exercise the borrowing powers immediately after its incorporation.

The power to borrow money is generally exercised by the directors but Articles normally provide for certain restrictions on their power to borrow. Section 293 also limits the directors' power to borrow, to the aggregate of the paid up capital of the company and its free reserves apart from temporary loans obtained from the company's bankers in the ordinary course of business.

The powers of a company are determined by the memorandum and the articles of association. Therefore a company can borrow money, and if so to what extent, are matters depending upon the interpretation of these two documents.

Generally borrowing powers of a company are determined by the memorandum and the articles of association. That is why, depending upon the provisions of these two documents, a company, can borrow money. The memorandum and articles of a company may impose some restrictions on borrowing power of the company.

In such a case, the company is to strictly observe these restrictions. Because, borrowing in excess of the limits laid down by the articles is ultra vires the company and not binding on it.

As the commercial transactions necessarily involve the giving and taking of credit, so a trading company has an implied power to borrow.

Of course, such type of implied power is not entrusted to any non-trading company. In case of non-trading company, if their memorandum and articles do not permit to borrow money, then their provisions of memorandum and articles should be altered before taking any step to borrow money.

Where the memo and the articles give the power to borrow, loans may be taken in any one or more of the following ways: mortgage of immovable properties of the company; hypothecation or mortgage of movable goods, including stock in trade and, furniture; charge on uncalled capital; floating charge on all the assets of the company; mortgage of book debts; promissory notes, hundies and bills of exchange; debentures and debenture stock; charge on patents, licenses and copyrights and goodwill; overdrawing the company's banking accounts.

Unless any of the following ways of borrowing money is prohibited, the company can take any one of them as a way of borrowing money, subject to power given by the memorandum and articles to borrow money.

(i) Mortgage of immovable properties of the company.

(ii) Hypothecation on mortgage of movable goods, including stock in trade and furniture, charge on uncalled capital, floating charge on all the assets of the company, mortgage of book debts, promissory notes, hundies and bill of exchanges, debentures and debenture stock, charge on patents, licences and copyrights and goodwill, etc.

A company cannot borrow money on the security of its books of account because of the fact that these books of account are to be kept in the registered office and they are open for inspection. Besides on the security of the reserve capital, no company can borrow money.

Section 180 of the Companies Act, 2013 corresponds to section 293 of the companies Act, 1956 and the said section has been brought into effect from 12th September 2013.

The earlier section 293 and the new section 180 pertained to powers of the Board of Directors which can be exercised only at a general meeting by way of special resolution to be passed for the purpose. Section 293(1)(d) pertained to borrowing

powers of the companies i.e., the amount upto which the companies could borrow was laid down in the special resolution which was approved by the members in the general meeting.

Companies are allowed to borrow any sums of monies upto the paid up share capital and free reserves of the company. Any borrowal in excess of the combination of these two limits i.e., paid up share capital and free reserves required approval of the members in the general meeting by way of special resolution. Typically companies passed an omnibus resolution securing approval for ₹.X amount which was way above the paid up share capital and free reserves of the company but sufficient for the purposes of the company.

Section 293 of the Companies Act, 1956 was applicable only to public companies i.e., private limited companies were exempted from this requirement and therefore they could borrow any sums of money upto any limit without the need of seeking any approval from the members of the company.

Now Section 180 is applicable to all companies i.e., public as well as private. So now onwards even private companies have to seek the approval of their members if they are intending to borrow monies in excess of their paid up share capital and free reserves.

The relevant section 180(1)(c) states as follows:

180 (1) The Board of Directors of a company shall exercise the following powers only with the consent of the company by a special resolution, namely:

(c) to borrow money, where the money to be borrowed, together with the money already borrowed by the company will exceed aggregate of its paid-up share capital and free reserves, apart from temporary loans obtained from the company's bankers in the ordinary course of business:

Provided that the acceptance by a banking company, in the ordinary course of its business, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise, shall not be deemed to be a borrowing of monies by the banking company within the meaning of this clause.

Explanation—For the purposes of this clause, the expression "temporary loans" means loans repayable on demand or within six months from the date of the loan such as short-term, cash credit arrangements, the discounting of bills and the issue of other short-term loans of a seasonal character, but does not include loans raised for the purpose of financial expenditure of a capital nature;

Every special resolution passed by the company in general meeting in relation to the exercise of the powers referred to in clause (c) of sub-section (1) shall specify the total amount up to which monies may be borrowed by the Board of Directors.

No debt incurred by the company in excess of the limit imposed by clause (c) of sub-section (1) shall be valid or effectual, unless the lender proves that he advanced the loan in good faith and without knowledge that the limit imposed by that clause had been exceeded.

Statutory Limitations on Borrowing

1. The Companies Act prohibits the directors to borrow money beyond the aggregate of the paid-up capital and its reserves.
2. Borrowing by a company may be ultra vires the company or intra vires the company but ultra vires the directors.

6.9.1 Ultra Vires Borrowing

Borrowing by a company shall be deemed to be ultra vires where the company borrows inspite of no power to borrow or borrows beyond the limit fixed by the Memorandum or Articles. Any such loan to the company is null and void and does not create an actionable debt. However, the following remedies shall be available to such a lender:

1. ***Injunction and Recovery.*** If the money, assets, property, etc., purchased with such money is identifiable and are still in the possession of the company, the lender can obtain an injunction to restrain the company from parting with them and seek a tracing order to trace and recover them.

2. ***Subrogation.*** If the borrowed money was applied in payment of lawful creditors of the company, the lender can subrogate to the rights of those creditors, i.e., he will step into the shoes of the old creditors for the purpose of recovering his money [*Sinclair v. Brougham (1914) A.C. 398*]. However, he shall not have any priority over other creditors even if the debts paid off had priority [*Re. Wirexhan Mold & Colmah's Quan Rly (1899) 1Ch. 440*].

3. ***Suit against the Directors.*** The lender may claim damages from the directors and sue them personally for a breach of warranty of authority [*Firbank's Executors v. Humphreys (1866) 18 O.B.D.64*]. But if the fact that the company has no powers to borrow was apparent upon reference to the company's memorandum or articles, the lender shall not be entitled to claim damages from directors upon this ground as he was not misled because he is deemed to have knowledge of these public documents [*Ranshdall v. Ford (1866) E.R.Q. Eq Cas. 750*].

6.9.2 Borrowing Intra Vires the Company but Ultra Vires the Directors

If the borrowing is in excess merely of the power of directors but not of the company, e.g., where the articles provide that the directors shall have power to borrow only upto ₹2,00,000 and for borrowing beyond this amount prior approval of the shareholders in general body meeting must be obtained any borrowing beyond ₹2,00,000 without shareholders' approval (i.e., ultra vires the directors) can be ratified and rendered valid by the company. If ratified, the loan shall become perfectly valid and binding upon the company. However, even where the company refuses to ratify the directors' act, the 'doctrine of indoor management' shall protect a lender provided he can establish that he advanced the money in good faith. The company may in turn proceed against the directors and claim indemnity.

6.9.3 Other Restrictions on the Borrowing Powers of the Board

The Board can exercise the following powers, inter alia, only by means of resolutions passed at Board meeting and not by the circulation of resolution: (i) the power to issue debentures, (ii) the power to borrow moneys otherwise than on debentures. The Board may, however, by a resolution passed at a meeting, delegate the power in (ii) above, to any committee of directors, the managing director, the manager or any other principal officer of the company, mentioning therein the limit up to which amount can be borrowed by the delegatee. Also the Act empowers the company in general meeting to impose restrictions and conditions on the powers of the Board to issue debentures and borrow money.

6.9.4 Procedure for Delegating Powers to Borrow Monies otherwise than on Debentures

Section 292 empowers the Board to borrow money on behalf of the company by means of resolution passed at the meeting of the Board. However, Section 292(1)

permits the Board to delegate, by means of a resolution passed at a meeting, to a committee of directors, the manager or any other principal officer of the company, the power to borrow money otherwise than on debentures.

Section 292(2) further provides that every resolution delegating the power referred to above relating to the power to borrow money otherwise than on debentures must specify the total amount outstanding at any one time up to which money may be borrowed by the delegate. In case, company has a branch office, the power to borrow as referred to above may be delegated to the principal officer of such branch.

Thus, to summarise, the company should follow the following procedure for delegating its power to borrow money otherwise than on debentures: (1) Convene a meeting of the Board of directors. (2) Ensure that every director gets the proper notice of the meeting along with the agenda. (3) Pass a resolution in the Board's meeting delegating the stated power to the desired official of the company. (4) Ensure that the resolution does state the maximum amount that the official shall be allowed to borrow.

Check Your Progress

Fill in the blanks:

1. A _____and _____is an acknowledgement given by the firm for having received a sum of amount as debt.
2. A debenture is an instrument issued by the company under its _____acknowledging a debt and setting forth the terms under which they are issued and are to be paid.
3. Company should create _____equivalent to atleast 50 percent of the amount of issue before commencement of repayment of debenture.
4. _____is the same as zero coupon bonds but it is issued at a deep discount from its redeemable (maturity) value.
5. _____is a charge on definite or specific property, i.e., the charge attaches to the property that is identified at the time when the charge is created, e.g., land, heavy machinery, buildings.

6.10 LET US SUM UP

- Every trading company has an implied power to borrow. However, a public company cannot exercise its borrowing powers until it obtains the certificate to commence business.
- A company may issue debentures for the purpose of borrowing money. The term 'debenture' means a document acknowledging a loan made to the company and providing for the payment of interest on the sum borrowed until the debenture is redeemed.
- Debentures are commonly issued in a similar manner as shares by means of a prospectus inviting applications. Debenture may, be issued at par, at a premium or at a discount.
- There are different kinds of debenture. viz. (i) Bearer, (ii) registered; (iii) redeemable, and (iv) convertible.

- A company's power to borrow includes the power to charge the assets of the company by way of security to the lender. This charge may either be a fixed charge or a floating charge.
- A fixed charge is a charge on definite or specific assets of the company. These assets are identified at the time the charge is created. Floating charge, on the other hand, is not attached to any specific assets, but is a charge on assets — present and future.
- Floating charge is generally created on the class of assets, which in the ordinary course of business, are changing from time to time. Thus stock-in-trade is the best example of asset on which a floating charge is created.
- In the case of fixed charge, a company cannot dispose of the asset, free of charge, without the consent of the holders of that charge. On the other hand, in the case of a floating charge, the company can dispose of the asset, without the consent of the holders of that charge. Section 125 requires certain charges to the registered with the registrar within 30 days their creation.

6.11 LESSON END ACTIVITY

The Board of Directors of XYZ Ltd. borrowed ₹20 lacs against hypothecation of stocks. The returns prescribed in this regard were not filed with the Registrar. Advise the lender and the borrower of the implications.

6.12 KEYWORDS

Debenture: 'Debenture' includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the company's assets or not.

Convertible Debenture: It is that debenture which includes an option to the debentureholder to convert it into equity or preference share at a stated rate of exchange, after a certain period.

Fixed Charge: It is a charge on specific assets of the company, identified at the time of creation of the charge.

Floating Charge: It is charge not on any specific assets of the company, but is a charge on assets present and future of the company.

6.13 QUESTIONS FOR DISCUSSION

1. What are the legal requirements which a company must comply with while borrowing?
2. What is ultra vires borrowing? What remedies are available to a lender if a company resorts to ultra vires borrowing?
3. What is a debenture? What are the different kinds of debentures that may be issued by a company? Distinguish between a share and a debenture.
4. What is a floating charge? Explain the circumstances in which a 'floating charge' becomes fixed.
5. Distinguish between floating and fixed charge.
6. What charges are registered under the Companies Act, 1956?
7. What is the effect of non-registration of a registrable charge?

8. "All investments made by a company must be held by it in its own name." Discuss.

Check Your Progress: Model Answer

1. Debenture. bond
2. Common seal
3. Dividend Redemption Reserve (DRR)
4. Deep discount bond
5. Fixed charge

6.14 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi

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UNIT IV

LESSON

7

DIRECTORS

CONTENTS

Contd ..

7.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Describe about directors
- Identify the legal provisions of directors
- Discuss about managing director and whole time director
- Explain the appointment of directors
- Discuss the compensation to directors for loss of office
- Identify the remuneration of managerial personnel
- Discuss the meetings of directors
- State the powers, duties and liabilities of the board of directors

7.1 INTRODUCTION

A company being an artificial person acts through human agency. Accordingly, under the Act, it is necessary for every company to have a Board of Directors. In addition to this, the following categories of managerial personnel may be appointed (Section 197-A): (i) Managing Director; or (ii) Manager. But Section 197A does not prohibit the employment of other managerial personnel such as executives or wholetime directors, which do not come within the term "managing director" or "manager".

The executive management of a company is responsible for the day to day management of a company. The Companies Act, 2013 has used the term key management personnel to define the executive management.

The key management personnel are the point of first contact between the company and its stakeholders.

While the Board of Directors are responsible for providing the oversight, it is the key management personnel who are responsible for not just laying down the strategies as well as its implementation.

Chapter XIII of the Companies Act, 2013 read with Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 deal with the legal and procedural aspects of appointment of Key Managerial Personnel including Managing Director, Whole-time Director or Manager, managerial remuneration, secretarial audit, etc.

The Companies Act, 2013 has for the first time recognised the concept of Key Managerial Personnel. As per section 2(51) "key managerial personnel", in relation to a company, means:

(i) The Chief Executive Officer or the Managing Director or the Manager;

(ii) The Company Secretary;

(iii) The Whole-time Director;

(iv) The Chief Financial Officer; and

(v) Such other officer as may be prescribed.

7.2 MEANING OF DIRECTORS

Section 2(13) defines a director as including "any person occupying the position of director, by whatever name called". This is a definition based purely on function; a person is a director if he does whatever a director normally does. But the Act gives no further guidance on the function, duties and position of a director.

In reality, directors are the persons who direct, conduct, manage or superintend a company's affairs. Section 291 has entrusted the management of the affairs of the company in their hands. They chalk-out the general policy of the company within the framework of the Memorandum of the company. They appoint the company's officers and recommend the rate of dividend. The directors of company are collectively referred to as the 'Board of Directors'.

The exact position of 'director' is hard to define, as no formal definition, either statutory or judicial, of the term has been given. However, judicial pronouncements have described them as (i) agents, (ii) trustees, or (iii) managing partners.

The directors act as agents of the company and the ordinary rules of agency apply. They exercise the powers and are subject to duties within the framework of the company's Articles, and the Act. For instance, they may make contracts on behalf of the company and they will not be personally liable as long as they act within the scope of their authority.

But if they contract in their own name, or fail to exclude personal liability, they also will be liable. If the directors exceed their authority, the same act may be ratified by the company. But if they do something beyond the objects clause of the company, then the act is *ultra vires* and the company cannot ratify the same. But directors are not agents for the individual shareholders; they are the agents of the company – the artificial person.

The directors have also been described as trustees. But they are not trustees in the full sense of the term in as much as no proprietary rights of the company's property are transferred to them and therefore, they enter into contracts on behalf of the company and in the name of the company.

On the other hand, in the case of a trust, the legal ownership of the trust property is transferred to the trustee and therefore, he can enter into contract in his own name, but whatever he does, he does for the benefit of the beneficiaries.

Although directors are not trustees in the real sense of the term, they occupy an office of the trust and are in certain respects in the position of trustees for the company. Such cases are:

(i) They are trustees of money which comes to their hands or which is actually under their control. If they misapply company's money, they have to make good the same as if they were trustees.

(ii) They are trustees for exercising powers conferred on them for the benefit of the company. For instance, powers to allot shares, to make calls, forfeit shares should be exercised *bona fide* in the interests of the company.

(iii) They stand in a fiduciary relationship to the company and, therefore, whenever there is clash of his personal interests with that of the company, he should keep in mind the company's interests.

A director is in no way a trustee for individual shareholders except when the former induces the latter by misrepresentation to sell the shares to him.

The directors are also sometimes described as managing partners. They manage the affairs of the company on their own behalf and on behalf of other shareholders who elect them.

Are the directors employees of the company? They are not employees of the company or employed by the company, nor are they servants of the company, or members of "Company's staff". A director can, however, hold a salaried employment or an office in addition to that of his directorship which may, for these purposes, make him an employee or servant and in such a case he would enjoy rights given to employees as such: but his directorship and his rights through that directorship are quite separate from his rights as employee.

7.3 LEGAL PROVISIONS OF DIRECTORS

Some of the important legal provisions as regards directors are summarised as follows:

7.3.1 Number of Directors

Every public company must have atleast three directors. Every private company must have atleast two directors (Section 252). However, a public company having: (a) a paid-up capital of ₹5 crore or more; (b) 1000 or more small shareholders may have a director elected by such small shareholders in the manner as may be prescribed.

The phrase 'small shareholders' means a shareholder holding shares of nominal value of ₹20,000 or less in a public company to which this section applies. This is the minimum legal requirement of the number of directors. The articles of a company may and usually do, fix the minimum and maximum number of directors of its board.

For instance, the articles may fix 5 as the minimum and 9 as the maximum number of directors of the board. Also, the articles may fix, within these limits, the number which will constitute the board for the time being. For instance, in the above example, the number of directors constituting a board may be fixed at 7.

7.3.2 Increase in Number of Directors

A company in general meetings may, by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its articles (Section 258).

In certain cases, the increase in number of directors also requires the approval of the Central Government. Section 259 provides that if a public company, or a private company which is subsidiary a public company wishes to increase the number of its directors beyond the maximum fixed by its articles, the increase even though decided upon by resolution of the company in general meeting will not have any effect unless approved by the Central Government and shall become void if and in so far as it is disapproved by the Central Government.

7.3.3 Individuals to be Directors

No body corporate, association or firm shall be appointed director of any company. Only an individual can be a director (Section 253).

Director Identification Number etc.: The Companies (Amendment) Act, 2006 has amended Section 253, and inserted new sections 266A, 266B, 266C, 266D, 266E, 266F and 266G. These are summarised below:

1. ***Amendment of Section 253.*** A proviso to Section 253 now provides that no company shall appoint or reappoint any individual as director of the company unless he has been allotted a Director Identification Number (DIN) under Section 266B.

2. ***Application for allotment of DIN (Section 266A).*** An application for allotment of DIN has to be made to the Central Government for allotment of DIN by the following:

   (a) An individual, intending to be appointed as director of a company; or

   (b) The director of a company appointed before the commencement of the Companies (Amendment) Act, 2006.

3. In (ii) case, the application to the Central Government for the allotment of DIN has to be made within 60 days of the commencement of the Act.

   Further every applicant, who has made an application under this section for allotment of DIN may be appointed as a director in a company or, hold office as director in a company till such time such applicant has been allotted DIN.

4. ***Allotment of DIN (Section 266B):*** The Central Government shall, within one month from the receipt of the application under Section 266A, allot a DIN to an applicant.

5. ***Prohibition to obtain more than one DIN:*** No individual, who had already been allotted a DIN under Section 266B, shall apply, obtain or possess another DIN.

6. ***Obligation of director to intimate DIN to concerned Company or Companies (Section 266D):*** Every existing director shall, within one month of the receipt of DIN from the Central Government, intimate his DIN to the company or all companies wherein he is a director.

7. ***Obligation of company to inform DIN to Registrar (Section 266E):*** This section provides that every company shall, within one week of the receipt of intimation under Section 266D, furnish the DIN of all its directors to the Registrar or any other officer or authority, as may be specified by the Central Government.

8. ***Obligation to indicate DIN (Section 266F):*** This section provides that every person or company, while furnishing any return, information or particulars as are required to be furnished under the Act, shall quote the DIN in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of the director.

9. ***Penalty for contravention of provisions of Sections 266A, 266C, 266D or 266E, (Section 266G):*** If any individual or director, referred to in Section 266A or 266C or 266D or a company referred to in Section 266E, contravenes any of the provisions of those sections, every such individual or director of the company, as the case may be, who or which, is in default, shall be punishable with fine which may extend to ₹5000 and where the contravention is continuing one with a further fine which may extend to ₹500 for every day after the first during which the contravention continues.

7.3.4 Number of Directorships

A person cannot hold office at the same time as a director in more than twenty companies (Section 275). In computing this number of 20 directorships, the directorships of (i) private companies (other than subsidiaries) (ii) unlimited companies (iii) non-profit association and (iv) alternated directorships will be omitted (Section 278).

If a person who is already a director of 20 companies, is appointed a director in any other company, the appointment will not be effective unless within 15 days thereafter, the director so has vacated his office in any of the companies in which he was already a director as to keep the number within the maximum allowed.

None of the new appointments of director shall take effect until such choice is made and all the new appointments will become void if the choice is not made within 15 days from the day on which the least of them were made (Section 277).

Any person who holds office of, or acts as a director of more than 20 companies in contravention of the foregoing provisions is liable to be fined upto ₹5,000 in respect of each of those companies after the first 20 companies (Section 279).

Example. If a person is already a director of 20 public companies and if a private company of which he is a director has become a public company under Section 43-A, then, he will have to give up the directorships of one of those companies.

7.3.5 Qualifications and Disqualifications of Directors

The Act has not prescribed any academic or professional qualifications for the directors. Also, the Act imposes no share qualification on the directors. So, unless the company's Articles contain a provision to that effect, a director need not be a shareholder unless he wishes to be one voluntarily.

But the Articles usually provide for a minimum share qualification. Where a share qualification is fixed by the Articles of a company, the Act provides (Section 270) that: (i) it must be disclosed in the prospectus; (ii) each director must take his qualification shares within two months after his appointment; (iii) the notional value of the qualification shares must not exceed ₹5,000 or the nominal value of the one share where it exceeds ₹5,000; (iv) share warrants will not count for purposes of share qualification.

If a director fails to obtain his share qualification within two months, he vacates office automatically on the expiry of two months from the date of his appointment and if he acts as director after the expiry of two months without taking the qualification shares, he is liable to a fine up to ₹50 for every day until he stops acting as such (Section 272).

However, the articles of a company cannot compel a person to hold qualification shares before he is elected a director nor can they require him to obtain qualification shares within a shorter period than two months after his appointment and if any provisions to this effect is made in the Articles, it shall be void.

The effect of this provision is that, if the company is wound up during this period of two months, the director cannot be placed in the list of contributories, in as much as there is no express or implied contract under which he would be bound to take the qualification shares, since his name cannot be put on the register of members unless he has applied for shares and these are allotted to him [*Zamir Ahmed Raz. v. D.R. Banaji (1957) 27 Comp. Cas. 634*].

However, a private company which is not a subsidiary of a public company may, by its Articles, provide additional qualifications for a director, such as, a person must be a B.Com. or holding a fixed deposit receipt in his own name issued by the company.

Section 274 has laid down certain disqualifications and therefore, the following persons are incapable of being appointed directors of any company:

(i) A person found by the court to be of unsound mind;

(ii) An undischarged insolvent;

(iii) A person who has applied to be adjudged an insolvent;

(iv) A person who has been convicted anywhere in the world for an offence involving moral turpitude and sentenced in respect thereof to imprisonment for not less than six months and a period of five years has not elapsed from the date of the expiry of the sentence;

(v) A person who has failed to pay calls on shares for six months from the date fixed for the payment;

(vi) A person who has been disqualified by court under Section 203 which empowers the court to restrain fraudulent persons from managing companies;

(vii) Such person is already a director of a public company which, (a) has not filed the annual accounts and annual returns for any continuous three financial years; or (b) has failed to repay its depositor interest there on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more. Further such person shall not be eligible to be appointed as a director of any other public company for a period of 5 years from the date on which such public company, in which he is a director, failed to file annual accounts and annual returns under (a) above or has failed to repay its deposit or interest or redeem its debentures on due date or pay dividend referred to in (b)

The disqualifications mentioned under (iv) and (v) above may be removed by the Central Government by a notification in the Official Gazette. On the other hand, a private company may provide in its Articles that a person shall be disqualified for appointment as director on any other additional ground. However, a subsidiary private company or a public company cannot, by its Articles, provide for any additional disqualifications.

Minor as a director. In the case of a minor, though there is no provision in the Act, expressly disqualifying him, as he is not competent to contract, he cannot file either with the company or with the Registrar any valid consent to act as director, as required by Section 264. But as Section 264 applies only to public companies there is nothing prohibiting a minor being a director of a private companies.

However, from a practical point of view a minor can be an ornamental director as he cannot be party to any transaction which requires competency to contract – nor, for the same reason, can he be delegated any powers of the Board. He may possibly vote on all resolutions at Board meetings.

7.3.6 Vacation of Office of a Director

Section 283 provides for the office of the director becoming vacant on the happening of certain contingencies. It provides that the office of a director shall become vacant if:

(i) He is found to be of unsound mind by a competent court;

(ii) He is adjudged insolvent;

(iii) He fails to obtain within two months of his appointment, or ceases to hold at any time thereafter his share qualification, if any;

(iv) He is convicted of any offence involving moral turpitude and sentenced to imprisonment for not less than six months;

(v) He fails to pay any call within six months from the last date fixed for the payment;

(vi) He absents himself from three consecutive meetings of the Board of Directors, or from all meetings of the board for a continuous period of three months, whichever is longer, without obtaining leave of absence from the Board;

(vii) He becomes disqualified by an order of the court under Section 203 which restrains fraudulent persons from managing companies;

(viii) He is removed in pursuance of Section 284 by an ordinary resolution of which special notice was given;

(ix) He accepts a loan from the company in contravention of Section 295;

(x) He fails to disclose to the Board his interest in any contract entered into by the company as required by Section 299;

(xi) If he became the director by virtue of an office, on coming to an end of that office. A private company may provide additional grounds in its Articles for vacation of office of a director.

If a person functions as a director after the office has become vacant on account of any of the disqualifications specified in (i) to (xi), he shall be punishable with fine upto ₹ 500 for everyday during the period he so functions.

7.3.7 Removal of Directors

A director may be removed under Sections 284 or 388B-E.

Removal by shareholders: Section 284 provides that company may by ordinary resolution passed in general meeting after special notice, remove a director before the expiry of his term of office. But the following directors cannot be removed by the company in general meeting: (i) a director appointed by the Central Government under Section 408; (ii) a director of a private company holding office for life on April 1, 1952; (iii) director elected by the principle of proportional representation under Section 265.

On receipt of the special notice, the company must forthwith send a copy thereof to the director concerned to enable him to make a representation. If he makes a representation in writing and requests the company to notify it to the members, the company must, unless it is received by it too late for it to send to the members, state the fact of the representation in any notice of the resolution given to the members.

It should also send a copy of the representation to every member of the company to whom notice of the meeting is sent. If the representation is not sent as aforesaid the company must at the instance of the director concerned read it out at the meeting. The director is also entitled to be heard on the resolution at the meeting.

The vacancy caused by the removal of a director may be filled at the same meeting and if so filled, person appointed thereto will only hold office for the residue period of the removed director.

If the vacancy is not filled by the company in general meeting, the Board of Directors may fill it as if it were a casual vacancy in accordance with Section 262, but the Board cannot appoint the removed director.

Removal by central government: The provisions of Sections 203 and 204 prohibit certain persons from acting or being appointed as directors and provide for their removal only if they were convicted for offences involving moral turpitude. In all those cases conviction or finding of guilt by the court is the prerequisite for bringing about vacation of office.

Strict proof of guilt in a criminal case is essential and very often such persons may go scot-free in spite of malpractices. The finding of the Tribunal will enable the Central Government to take quick action against persons involved in cases of fraud, etc. For this purpose a Chapter IV-A and Sections 388B to 388E have been inserted in the Act.

Under Section 388B, the Central Government has the power to make a reference to the Company Law Board against any managerial personnel. The power can be exercised where, in the opinion of the Central Government, there are circumstance suggesting:

(a) Any person concerned in the conduct and management of the affairs of a company is or has been guilty of fraud, misfeasance, persistent negligence of default in carrying out his obligations and functions under the law, or breach of trust in connection therewith; or

(b) That the business of the company is not or has not been conducted and managed by such person in accordance with sound business principles or prudent commercial practices; or

(c) That the business of the company is or has been conducted or managed by such person in a manner which is likely to cause or has in fact caused, serious injury or damage to the interest of trade, industry or business to which such company pertains; or

(d) That the business of the company is or has been conducted and managed by such person with an intent to defraud its creditors, members, or any other person or otherwise for a fraudulent or unlawful purpose or in a manner prejudicial to public interest.

The reference may be made by stating a case against the person aforesaid with a request that the Company Law Board may inquire into the case, record finding as to whether or not such person is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company.

The statement of the case by the Central Government should be in the form of an application presented to the Company Law Board and the person against whom such case is stated and referred should be joined as a respondent to the application.

The application should contain a concise statement of such circumstances and materials as the Central Government may consider necessary for purpose of inquiry to be made by the Company Law Board. The application must be signed and verified in the same manner as a plaint in a suit by the Central Government under the Code of Civil Procedure.

Thereafter, the Company Law Board will hear the case against the respondent. At any stage of the proceedings, the Company Law Board may allow the Central Government to alter or amend the application in such manner and on such terms as may be just and all such alterations and amendments shall be made as may be necessary for the purpose of determining the real question in the inquiry (Section 388-B).

If during the pendency of the case of Company Law Board finds it necessary, in the interest of the members or creditors of the company, it may, either on the application of the Central Government or of its own motion, direct that the respondent shall not

discharge any of the duties of his office until further orders and appoint in his place another suitable person to discharge the duties of the respondent.

This person who is temporarily appointed to discharge the duties in place of the respondent will be regarded as a public servant within the meaning of Section 21 of the Indian Penal Code (Section 388-C).

At the conclusion of the hearing of the case, the Company Law Board shall record its findings, stating therein specifically as to whether or not respondent is a fit and proper person to hold the office of director or any other office connected with the conduct and management of any company (Section 388-D).

On the basis of the aforesaid findings, the Central Government may, by order, notwithstanding any other provisions contained in the Act, remove the delinquent respondent from his office [Section 388-E(1)].

An order under Section 388E must not be passed against any person unless he has been given a reasonable opportunity to show cause against the order. However, no matter can be raised by such a person before the Central Government, which has already been decided by the Company Law Board [Section 388-E(2) and proviso thereto].

After the delinquent person has been, by order, removed, he shall not hold any office for a period of 5 years from the date of the order of removal, nor will he be paid any compensation for loss of office as a result of removal.

The time-limit may, however, be relaxed by the Central Government with the previous concurrence of the Company Law Board, and the Central Government may accordingly permit such person to hold the office of a director or any other office connected with the conduct and management of the affairs of the company even before the expiry of the period of 5 years.

On the removal of the person, the company may, with previous approval of the Central Government, appoint another person to that office in accordance with the provisions of the Act.

7.3.8 Resignation by a Director

There is nothing in the Act as to whether and by what procedure, a director can resign. The Act, however, indirectly recognises resignation through the provisions in Section 318 one of which is that no director is entitled to compensation if he resigns his office. In S.S. Lakshmana Pillai v. Registrar of Companies (1977) 47 Comp. Cas. 652 (Mad), it was held, that if there is a provision in the articles, resignation will take effect in accordance with such provision and if there is no provision, resignation will take effect in accordance with its terms. Notice may be written or oral.

7.3.9 Directors not to Hold Office or Place of Profit

Section 314 imposes certain restrictions on the holding of office or place of profit in a company by the directors and their associates. Following is the summary of restrictions so provided:

1. No director of a company shall hold any office or place of profit (carrying any remuneration) under the company or its subsidiary except with the consent of the company by a special resolution. It shall, however, be sufficient if the special resolution is passed at the first general meeting held after such appointment.

   A director shall be deemed to hold an office or place of profit under the company if the director holding an office obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such

director. Such remuneration may be by way of salary, fees, commission, perquisites, the right to occupy free of rent any premises as a place of residence or otherwise.

2. Except by passing a special resolution, partner or relative of such director, no firm in which such director or a relative of such director, is a partner, no private company of which such director is a director or member and no director, or manager of such a private company shall hold any office or place of profit carrying a total monthly remuneration of such sum as may be prescribed (presently ₹3,000 per month). Again, special resolution may be passed at the first general meeting after the appointment made. Where, however, the aforesaid appointment made without the knowledge of the director, the consent of the company may be obtained either in the general meeting aforesaid or within 3 months from the date of the appointment, whichever is later.

   However, a director or any of his associates may be appointed as managing director, manager, banker or trustee for the debentureholders of the company without sanction of special resolution, if the remuneration received from such subsidiary in respect of such office or place of profit is paid over to the company or its holding company

   For the aforesaid appointment of a director or his associates, special resolution shall not only be necessary at the time of first appointment but also for every subsequent appointment on a higher remuneration not covered by the special resolution except where an appointment on a time-scale has already been approved by the special resolution.

   It may be noted that the aforesaid restrictions do not apply where a relative of a director or a firm in which such relative is a partner holds any office or place of profit under the company or a subsidiary thereof having been appointed to such office or place before such director became a director of this company.

3 (i) No partner or relative of a director or manger, (ii) no firm in which such director or manger, or relative of either is a partner, (iii) no private company of which such a director or manager, or relative of either, is a director member, shall hold an office or place of profit in the company carrying a total monthly remuneration of not less than such sum as may be prescribed (Presently, ₹6,000 per month). The aforesaid appointment may, however, be made by passing a special resolution and the approval of the Central Government.

   If any director or his associate holds an office or place of profit in contravention of the aforesaid provisions, then: (i) he shall be deemed to have vacated such office or place of profits as such on and from the date next following the date of the general meeting, (ii) he shall be liable to refund to the company any remuneration received or the monetary equivalent of the perquisites or advantage enjoyed by him. The company cannot waive the recovery any sum refundable to it as above unless permitted to do so by the Central Government.

The aforesaid restrictions do not apply to a person who being the holder of any office of profit in the company is appointed by the Central Government, under Section 408, as a director of the company

Meaning of 'Office or Place of profit': Any office or place shall be deemed to be an office or place profit under the company:

(a) In case the office or place is held by a director, if the director holding it obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director, whether as salary, fees,

commission, perquisites, the right to occupy free of rent any premises as a place of residence, or otherwise;

(b) In case the office or place is held by an individual other than a director or by any firm, private company or other body corporate holding it obtains from the company anything by way of remuneration whether as salary, fees, commission, perquisite, the right to occupy free of rent any premises as a place of residence or otherwise.

7.4 MANAGING DIRECTOR

Section 2(26) defines 'managing director' as a 'director' who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him. The expression includes a director occupying the position of a managing director, by whatever name called.

However, the power to do administrative acts of routine nature when so authorised by the Board such as the power to affix the common seal of the company to any document or to draw and endorse any cheque on the account of the company in any bank or to draw and endorse any negotiable instrument or to sign any certificate of share or to direct registration of transfer of any share, shall not be deemed to be included within substantial powers of management. Further, a managing director of a company shall exercise his powers subject to the superintendence, control and direction of its Board of Directors.

Some of the more important legal provisions about managing directors are summarised as:

(i) He, being a director, must be an individual.

(ii) He is appointed, usually to perform such functions and carry out such duties as may be assigned to him by the Board of Directors to whom he is responsible or subject. The Board can revoke the authority of the managing director.

(iii) He must be entrusted with substantial powers of management.

(iv) There can be two or more than two managing directors in a company.

(v) A person cannot be appointed as managing director of more than two companies unless so permitted by the Central Government.

His appointment is subject to the approval by the Central Government. The Central Government upon application for permission to appoint a person as managing director of the company has power to impose conditions. Sections 268, 269, 316 and 317 are applicable to a public company or a private company which is subsidiary of a public company.

Section 268 states that an amendment of any provision relating to appointment or re-appointment of a managing director (or a wholetime director) shall not be effective unless approved by the Central Government and shall be become void if and in so far as, it is disapproved by the Central Government.

Appointment of managing or whole-time director or manager to require government approval only in certain cases (Section 269). Every public company and/or private company which is a subsidiary of a public company having a paid-up share capital of not less than ₹5 crore must appoint either a managing or a whole-time director or Manager.

Also no approval of the Central Government to the appointment of managerial personnel is required on fulfillment of certain conditions laid down in Schedule XIII [including the minimum remuneration under Section 198(4) as also increase in the remuneration under Sections 310 and 311].

For appointment of a managing, wholetime director or a manager, approval of the Central Government would not be required if the following conditions were satisfied:

(i) He had not been sentenced to imprisonment for any period or to fine exceeding ₹1,000 for conviction of an offence under any of the fourteen acts mentioned in Schedule XIII,

(ii) He had not been detained for any period under the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act 1974;

(iii) He has completed the age of 25 years but has not attained the age of 70 years;

(iv) He is not a managing or wholetime director or manager or in any way in wholetime employment elsewhere;

(v) He is citizen of India and is resident in India;

(vi) The company had neither suffered loss nor had inadequate profits, (a) during the preceding financial year immediate to the financial year in which appointment is made, or (b) in any of the three financial years out of the four financial years immediately preceding.

In case any of the above conditions are not complied with, an application must be made to the Central Government within 90 days of the appointment. If the appointment is not approved by the Central Government the appointee shall vacate the office immediately on communication of the decision by the Central Government.

Section 316 states that a person, who is either the managing director or the manager of any other company (including a pure private company), cannot be appointed a managing director of a public company or a private company which is a subsidiary of a public company.

But such an appointment can be made if the board of such company approves of the appointment by a unanimous resolution passed at the Board meeting specific notice of which had been given to all the directors then in India.

Also the Central Government is empowered to permit, by order, the same person to be managing director of more than one companies, if it is satisfied and it is necessary for their proper working that the companies should function as a single unit and have a common managing director.

Section 317 states that the term of office of a managing director cannot exceed five years at a time. Also re-appointments or extension can be made on the basis of 5 years tenure on each occasion, provided each time the re-appointment or extension is made by the company during two years of the existing term.

It may be emphasised that Sections 268, 269 and 317 relating to restrictions on appointment of managing directors (as noted above) do not apply to pure private companies.

Disqualification of a managing director: Section 267 prohibits the appointment or employment or the continuance of the appointment or employment of any person by a company as its managing director or wholetime director, if the said person:

(i) Is an undischarged insolvent or has at any time been adjudged an insolvent;

(ii) Suspends, or has at any time suspended payment to his creditors, or makes or has at any time made a composition with them; or

(iii) Is or has at any time, been convicted by a court of an offence involving moral turpitude.

It may be noted that these disqualifications are in addition to the ones mentioned in Section 272 (i.e., disqualifications of a director).

7.4.1 Whole Time Director

In many sections of the Companies Act, the term 'Whole time director' has been used side by side with that of the 'managing director'. Confusion is, therefore, likely to arise in respect of their respective position and role.

While the term 'managing director' has been specifically defined under Section 2(26), no such definition of a whole time director is available.

Explanation to Section 269, however, states that the expression 'whole time director' includes a director in the whole time employment of the company.

Regarding appointment/re-appointment and remuneration of whole time director, same provisions as are applicable to a managing director, are applicable.

Under Section 269, every public company and a private company which is a subsidiary of a public company must have a managing director a whole-time director if its paid-up share capital is ₹5 crores or more.

Similarly Sections 267 and 268 providing for disqualifications of managing directors and approval of Central Government for their appointment/re-appointment also make the provisions applicable to whole time directors.

Also, the provisions of Sections 309, 310 and 311 dealing with remuneration of directors and other managerial personnel are applicable to whole time directors.

7.4.2 Distinction between Managing Director and Whole Time Director

However, the following points of distinction between a managing director and a whole time director may be noted:

1. A managing director may be appointed in that capacity in two or more companies at the same time but a whole-time director, by virtue of his whole time employee cannot act as such in more than one company.
2. The tenure of a managing director of a public company or a private company which is the subsidiary of a public company cannot be more than five years at a time. There is no such restriction in the case of a whole-time director.

7.5 APPOINTMENT OF DIRECTORS

The appointment of directors rests in the following hands: (a) Subscribers to the Memorandum – Section 254; Clause 64 (Table A); (b) Company in general meeting – Sections. 255-57; 263-265; (c) Board of directors – Sections. 260, 262, 313; (d) Central Government – Section 408; (e) Third parties – Section 255.

7.5.1 Appointment of First Directors

The first directors are usually named in the articles of a company. The Articles may, however, instead of naming the first directors confer power on the subscribers, or majority of them to appoint the directors. Where the appointment is to be made by the

majority of subscribers, the majority of them (and not only the quorum fixed by the Articles) should be present if the appointment is to be valid.

Where there are no Articles or the Articles neither name them nor confer any such power on the subscribers, then Clause 64 of Table A in Schedule I to the Act confers powers on the subscribers or a majority of them to make the appointment of first directors.

Furthermore, if the Articles neither name them, nor do they contain a provision for their appointment by the subscribers and Table A is excluded, then the subscribers to the memorandum who are individuals are deemed to be the first directors of the company until the directors are duly appointed at a general-meeting of the company in accordance with the provisions of Section 255.

7.5.2 Appointment of Subsequent Directors

Sections 255 and 265 provide for three schemes for the constitution of the Board of Directors of a public company or a private company which is subsidiary of a public company. These are:

(i) All the directors retire at every Annual General Meeting [Section 255]; or

(ii) Atleast two-thirds of the total number of directors must be persons whose period of office is liable to determination by retirement by rotation (Section 255); or

(iii) Atleast two-thirds of the directors may be appointed by the principles of proportional representation, by a single transferable vote by a system of cumulative voting or otherwise and shall be directors for a period of three years at a time (Section 265).

The remaining directors in (ii) and (iii) and the directors generally of a pure private company, unless otherwise provided in the Articles, must also be appointed by the company in general meeting.

Thus, every company should have a duly constituted Board appointed in accordance with the provisions of Section 255. A general meeting is called by the 'first' directors after the allotment of shares in the case of a company limited by shares and in the case of any other company, after its incorporation, for the specific purpose of appointment of directors.

7.5.3 Appointment in General Meeting

Section 256 provides that at the first AGM after the general meeting at which the first directors are appointed in accordance with Section 255, the number nearest to one-third of the directors liable to retire by rotation must retire from office. The rotation for retirement shall be determined by the length of office of directors, or in case all were appointed on the same day, by lot. At every subsequent AGM, one-third of the directors must retire. This is known as retirement by rotation. The retiring directors are, however, eligible for re-election.

7.5.4 Deemed Re-appointment of a Retiring Director

Section 256 also provides for automatic reappointment of directors in certain cases. The company may fill the vacancy caused by the retirement of a director at the AGM by appointment of the same person or someone else, or decide not to fill the vacancy.

If the vacancy is not filled up and the company has not expressly decided not to fill it up, the meeting shall stand adjourned till the same day in the next week, at the same time and place and if at that meeting also the vacancy is not filled up and that meeting

also does not decide not to fill it up, the retiring director shall be deemed to have been elected at the adjourned meeting except where:

(i) At that meeting or at the previous meeting a resolution for the re-appointment of such director had been put to vote but was lost; or

(ii) The retiring director has in writing expressed his unwillingness to continue; or

(iii) He has been rendered disqualified; or

(iv) A special or ordinary resolution is necessary for his appointment by virtue of any provisions of this Act; or

(v) It is resolved not to fill the vacancy.

In respect of an independent private company Section 256 does not provide for retirement of any director periodically. Therefore, in the absence of any provisions in the Articles, directors are entitled to continue until removed under Section 284 [S. Labh Singh v. Panaser Mech. Works (P) Ltd. (1987)].

7.5.5 Appointment of a Director other than a Retiring Director

Section 257 provides for the procedure of appointment of a person other than the retiring director.

If any person, other than the retiring director wishes to stand for directorship, he must signify his intention to do so by giving 14 days' notice to the company before the meeting and the company must inform the members not later than seven days before the meeting either by individual notices or by advertisement of this fact in atleast two newspapers circulating in the place where its registered office is situated, of which one must be in English and the other in the regional language of the place.

Also the candidate or the member who intends to propose him as director has to deposit a sum ₹500 which shall be refunded to such person or as the case may be, to such other member, if the candidate succeeds in being elected. In case such person is not elected as director, he or the member, as the case may be, will not be entitled to the refund of ₹500 and the amount deposited shall stand forfeited by the company.

Also Section 264 requires every person proposed as a candidate for the office of a director to sign and file first with the company his consent to act as a director, if appointed and then with Registrar within 30 days of his appointment.

Section 263 prescribes the mode of voting on appointment of directors. No motion can be made at a general meeting of a public company or a private company which is a subsidiary of a public company for the appointment of two or more persons as directors by a single resolution; unless a resolution is first unanimously passed that it shall be so made. Any resolution moved in contravention of this provision shall be void.

7.5.6 Appointment by Board of Directors

The Board of Directors can exercise the power to appoint directors in the following three cases: (i) Additional directors (Section 260). (ii) Filling up the casual vacancies (Section 262). (iii) Alternate directors (Section 313).

If the Articles authorise, the Board may appoint additional directors. Such additional directors together with the directors constituting the Board should not exceed the maximum number fixed by the Articles. Also, the additional directors are entitled to hold office only upto the date of the next AGM of the company (Section 260).

Section 262 empowers the Board to fill casual vacancies in the case of a public company or a private company which is subsidiary of a public company.

Thus, if the office of any directors appointed by the company in general meeting is vacated before his term of office expires in the normal course, the resulting casual vacancy, may, subject to any regulations in the Articles of the company, be filled by the Board of Directors at a meeting of the board.

Any person so appointed shall hold office only up to the date to which the original director would have continued if it had not been vacated.

By virtue of Section 313, alternate director, in place of a director who is absent from the State in which Board meetings are held for not less than three months, may be appointed by the Board, if so authorised by the Articles or by a resolution passed by the company in general meeting.

The alternate director shall not hold office for a period longer than that permissible to original director and shall vacate office when the original director returns to such State.

Also, if the term of office of the original director is determined before he so returns, any provision for the automatic reappointment (under Section 256) of retiring directors in default of another appointment shall apply to the original director and not to the alternate director.

The Articles of a company may authorise a director to appoint by will or otherwise his successor in office. This appointment is not hit by Section 312 which prohibits assignment of office by director

7.5.7 Appointment by Central Government

Section 408 empowers the Central Government to appoint directors on the Board of a company on the recommendation of Tribunal that it is necessary to appoint government directors to effectively safeguard the interests of the company or its shareholders or the public interest.

On the application of not less than 100 members of the company or of members holding not less than one-tenth of the total voting power therein, the Company Law Board may, if satisfied after making any inquiry it deems fit that it is necessary to prevent oppression and mismanagement and that the affairs of the company are being carried on in a manner which is prejudicial to the interest of the members or the company or the public, direct the appointment of as many persons (whether members of the company or not) as directors as it thinks fit to hold office for such period not exceeding three years on any one occasion.

The Company Law Board, however, instead of passing the above order direct the company to alter its Articles so as to arrange for the election of its directors on the principle of a proportional representation under Section 265.

A person appointed by the Central Government in pursuance of the above provisions shall not be: (a) considered for the purpose of reckoning 2/3rds or any other proportion of the total number of directors of the company [Section 408(3)]; (b) required to hold qualification shares [Section 408(4)]; (c) required to retire by rotation [Section 408(4)]; and (d) required to file written consent with the company under Section 264(1).

The Central Government may remove any such director from his office at any time and appoint another person to hold office in his place the provisions of this section are applicable to both public and private companies.

7.5.8 Appointment by Third Parties

Under Section 255, there cannot be more than one-third of the total number of directors, which are not subjected to retirement by rotation. The third parties may be

empowered by the Articles to nominate directors. Such third parties may be lenders of money – i.e., financial institutions, debenture holders.

7.6 MANAGER

Section 2(24) states that "manager means an individual who, subject to the superintendence, control and direction of the Board of Directors, has the management of the whole, or substantially the whole of the affairs of the company and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not".

Thus, an individual must be in charge of the whole or substantially the whole of the business of the company, in order to be called a manager in accordance with the Act. A person who is one of the departmental managers or a branch manager is not deemed to be a manager in this sense. Some of the more important legal provisions about managers are summarised as follows:

1. Only an individual can be appointed a manager of a company (Section 384).
2. Section 385 lays down the disqualifications of a Manager. No company shall appoint or continue the appointment or employment of any person as its manager, who (a) is an undischarged insolvent; or (b) has at any time within the preceding five years been adjudged an insolvent; or (c) suspends, or has suspended payment to his creditors; or (d) make, or has at any time, within the preceding five years made a composition with his creditors; or (e) is, or has at any time within preceding five years been convicted of an offence involving moral turpitude.
3. A person may not be appointed manager of more than 2 companies.
4. The provision of the following sections relating to managing directors have been made applicable to Manager also (Section 388); (a) Section 269: Appointment or re-appointment requires Government approval except in cases specified under Schedule XIII; (b) Sections 310-311: Provisions for increase in remuneration requires Government approval; (c) Section 312: Prohibition of assignment of office by a director; (d) Section 317: Term of appointment to be not more than five years at a time.

7.6.1 Distinction between a Managing Director and a Manager

The following points of distinction between the two are worth noting:

1. A managing director is entrusted with substantial powers of management. A 'manager', on the other hand, has the management of the whole or substantially the whole of the affairs of a company.
2. A company may have more than one managing director but it cannot have more than one manager.
3. A managing director is appointed either under an agreement or by a resolution of the Board or general meeting or under the provisions of the Memorandum or Articles. A manager, on the other hand, is usually appointed either under a contract of service of by the Board of Directors though the Articles may also provide for his appointment.
4. A managing director must be a director whereas a manager may or may not be a director.
5. A managing director, on his ceasing to be a director, shall automatically cease to be the managing director as well. A manager-director, however, can continue as a manager even though he ceases to be a director.

The grounds of disqualifications of a managing director as given in Section 267 remain effective for whole life and cannot be waived by the Central Government. Most of the grounds of disqualification of a manager as given in Section 385 are only for five years and can also be waived by the Central Government.

7.7 COMPENSATION TO DIRECTORS FOR LOSS OF OFFICE

Section 318 provides that no compensation for loss of office may be paid by a company to any director other than the managing director, or wholetime director, or a director holding the office of manager. Even in their cases, no such payment must be made:

(i) When he resigns his office on reconstruction or amalgamation of the company;

(ii) Where the office is vacated under Section 203 or Section 283;

(iii) Where he has to give up directorship beyond 20 directorships;

(iv) Here the winding up of the company takes place due to his negligence and mismanagement;

(v) Where he has been guilty of fraud or breach of trust in relation to, or of gross negligence in or gross mismanagement of the conduct of the affairs of the company or any subsidiary or holding company thereof;

(vi) Where he has instigated or has taken part directly or indirectly in bringing about the termination of his office.

Where, however, the compensation is payable, it must not exceed the remuneration which would have been earned by the director for the unexpired residue of the term or for three years whichever is shorter.

The calculation of this amount should be based on the average remuneration actually earned by him during a period of three years immediately prior to the date on which he ceased to hold the office, or where he held the office for a shorter period than three years, during such period.

No such payment can be made to him if the winding up has commenced either before or at any time within 12 months after the date of his ceasing to hold office, if the assets of the company are not sufficient to repay to the shareholders the share capital including the premium, if any, contributed by them.

7.8 REMUNERATION OF MANAGERIAL PERSONNEL

Section 198 provides that the total managerial remuneration payable by a public company or a private company which to its directors or manager in respect of any financial year must not exceed 11 percent of the net profit of that company for that financial year, in computing the above ceiling of 11 per cent computed in the manner laid down in Sections 349 and 359. The fees payable to directors for attending Board meetings is not included.

What is included in managerial remuneration? Explanation to Section 198 describes the term remuneration. According to it, for the purposes of Sections 309, 310, 311, 381 and 387, 'remuneration' includes the following: (a) any expenditure incurred by the company in providing rent-free accommodation, or any other benefit or amenity in respect of accommodation free of charge, to any of its directors or manager; (b) any expenditure incurred by the company in providing any other benefit or amenity free of charge or at a concessional rate to any of the persons aforesaid; (c) any expenditure

incurred by the company in respect of any obligation or service, which, but for such expenditure by the company, would have been incurred by any of the persons aforesaid; and (d) any expenditure incurred by the company to effect any insurance on the life of, or to provide any pension, annuity or gratuity for, any of the persons aforesaid or his spouse or child.

Section 309 contemplates three kinds of directors, i.e., (i) Managing Director; (ii) Whole-time Director; (iii) Director pure and simple. Further, Section 309 provides that subject to the general provisions of Section 198, dealing with the total managerial remuneration, the remuneration be determined by the articles, or by a resolution or, if the articles or require, by a special resolution, passed by the company in general meeting. Any remuneration paid for services in any other capacity shall not be included if: (a) the services rendered are of a professional nature; and (b) in the opinion of the Central Government, the director possesses the requisite qualifications for the practice of the profession.

A director who is neither in the whole-time employment of the company nor a managing director may be paid remuneration. (a) by way of a monthly, quarterly or annual payment with the approval of the Central Government; or (b) by way of commission, if the company by special resolution authorises such payment; or (c) by both.

However, in either of the above cases, the remuneration paid to such director, or where there is more than one such director, shall not exceed: (i) one percent of the net profit of the company, if the company has managing or wholetime director or manager; (ii) three percent of the net profits of the company in any other case. The company in general meeting may, however, with the approval of the Central Government, authorise the payment of a commission at a rate higher than one percent, or as the case may be, three percent of its net profits.

Each director is entitled to receive a sitting fee for each meeting of the Board or a committee thereof, provided the same is authorised by the articles.

A whole-time director or a managing director may be paid remuneration either by way of a monthly payment or at a specified percentage of the net profits of the company or partly by one way and partly by the other; provided that except with the approval of the Central Government such remuneration shall not exceed 5 percent of the net profits for one such director and if there is more than one such director, 10 percent for all of them together. Furthermore, a managing or whole-time director who is in receipt of any commission from the company cannot receive any remuneration from any subsidiary of the company.

If any director draws or receives, directly or indirectly, by way of remuneration any sum in excess of the limits stated above, without the sanction of the Central Government, where it is required, he shall have to refund such sums to the company and until the refund is made the money will be held by him in trust for the company. The company cannot waive the recovery of any sum refundable to it, unless permitted by the Central Government.

The provisions of Section 309 will not apply to a private company unless it is a subsidiary of a public company.

Increase in remuneration: Section 310 provides that every increase in the remuneration of any director including a managing or whole-time director granted or provided by any amendment in his term of appointment which has the effect of increasing, whether directly or indirectly, the amount payable to him would not be operative unless the same has been approved by the Central Government. *But no approval of the Central Government would be required if the increase in*

remuneration made is an accordance with the conditions specified in Schedule XIII. Also no approval of the Central Government is necessary, if the increase in the remuneration is only by way of fee for each meeting of the Board or a committee of the Board attended by any such director and the amount of the fee after such increase does not exceed such sum as may be prescribed. The Central Government has laid down differential scale of sitting fee according to the paid-up capital of the companies.

As regards remuneration payable to a Manager, Section 387 provides that he may receive remuneration either by way of a monthly payment or by way of a specified percentage of the 'net profits' of the company, or partly by one way and partly by the other. Such remuneration, however, must not exceed in the aggregate 5 percent of the net profits except with the approval of the Central Government.

Managerial remuneration vis-a-vis Schedule XIII: A public company is entitled to appoint its managerial personnel and fix their remuneration so long as the same is in accordance with the conditions laid down in Schedule XIII without seeking the prior approval of the Central Government. Schedule XIII, provides as follows:

Remuneration payable by companies having profits: Subject to the provisions of Section 198 and Section 309, a company having profits in a financial year may pay any remuneration, by way of salary, dearness allowance, perquisites, commission and other allowances, which shall not exceed 5 percent of its net profits for one such managerial person and if there are more than one such managerial persons, 10 percent for all of them together.

Remuneration payable by companies having no profits or inadequate profits: Where in any financial year during the currency of tenure of the managerial person, a company has no profits or its profits are inadequate, it may pay remuneration to a managerial person, by way of salary, dearness allowance, perquisites and other allowance, not exceeding ceiling limit of ₹24,00,000 per annum or ₹2,00,000 per month calculated on the following scale:

Table 7.1: Remuneration Paid by Companies

	Where the Effective Capital of the Company is Exceed	Monthly Remuneration Payable shall not Exceed
I.	Less than ₹1 crore	₹75,000
II.	₹1 crore or more but less than ₹5 crore	₹1,00,000
III.	₹5 crore or more but less than ₹25 crore	₹1,25,000
IV	₹25 crore or more but less than ₹50 crore	₹1,50,000
V.	₹50 crore or more but less than ₹100 crore	₹1,75,000
VI.	₹100 crore or more	₹2,00,000

In addition to the above, certain perquisites like contribution to provident fund, gratuity, leave encashment may be paid. Non-resident Indians may also be paid children education allowance, holiday passage for children studying outside India or family staying abroad, leave travel concession. These additional benefits shall be subject to the limits laid down in Schedule XIII.

The expression 'effective capital' shall mean the aggregate of the paid-up share capital (excluding share application money or advances against shares); amount, if any, for the time being standing to the credit of share premium account, reserves and surplus (excluding revaluation reserve); long-term loans and deposits repayable after one year (excluding working capital loans, overdrafts, interest due on loans unless funded, bank

guarantee, etc. and other short-term arrangements) as reduced by the aggregate of any investments (except in case of investments by an investment company whose principal business is acquisition of shares, stock, debentures or other securities), accumulated losses and preliminary expenses not written off.

Sitting Fee (Section 310): The sitting fee payable to a director for each meeting of the Board of Directors or a committee thereof shall not exceed ceiling prescribed by the Central Government (presently, ₹5,000). Any increase in the sitting fee payable to a director shall not require the prior approval of the Central Govt. if it falls within the prescribed limits.

7.9 MEETINGS OF DIRECTORS

The directors of a company are collectively known as Board and decisions are taken by them at a Board meeting. But in certain circumstances, resolutions of directors can be passed by circulating them among the directors. Also the Board may delegate powers to a director or a committee of directors.

Section 285 provides that a meeting of the Board of Directors of every company must be held atleast once in every three months and atleast four such meetings must be held in every calendar year.

The requisite quorum for a Board meeting is one-third of the total strength of the directors or two directors whichever is higher. For the purpose of counting number of directors forming the quorum, the directors who are interested in any contract to be entered into with the company should not be taken into account. In other words, only those who are disinterested in the matters to be discussed at the Board meeting will form the quorum. If the requisite quorum is not present at the meeting, it stands adjourned and will be held on the same day, time and place in the next week. If the quorum is not present at the meeting, any decisions taken or resolutions passed shall be invalid, but no quorum is necessary at the adjourned meeting.

The chairman for the meetings of the Board of Directors may either be named in the articles or he may be elected by the directors. The questions arising at the meeting of the directors are to be decided by a majority vote and the chairman of the Board will have a casting vote in case of equality of votes.

Resolutions by Circulation: As mentioned earlier, certain resolutions can be passed by circulation also. Section 289 states that the resolution to be passed by circulation must be circulated in a draft together with the necessary papers, if any, to all the directors, or to all the members of the committee, as the case may be, then in India (not less than the quorum fixed for a meeting of the Board or Committee of Directors) and to all other directors at their usual address in India. If the resolution is approved by such of the directors as are then in India, or by a majority of such of them as are entitled to vote on the resolution, it will be deemed to have been duly passed.

However, there are certain powers of the Board which can be exercised only at Board meetings and not through circulation. Sections 262, 292, 297, 316 and 488 provide for such matters.

7.10 POWERS OF THE BOARD OF DIRECTORS

Section 291 provides for general powers of the Board of Directors It provides:

Subject to the provisions of the Act, the Board of Directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do.

However, the board cannot exercise any power or do any act or thing which is directed or required, whether by this or any other Act or by the memorandum or articles of the company or otherwise, to be exercised or done by the company in general meeting. In exercising any such power or doing any such act or thing, the Board will be subject to the provisions contained in that behalf in this or any other Act, or in the memorandum or articles of the company, or in any regulations not inconsistent therewith and duly made thereunder, including regulations made by the company in general meeting.

Thus, the Board may exercise all powers of the company and can do all such acts and things that the company can do. But the exercise of such powers of the Board shall be in conformity with the provisions of the Companies Act or any other Act and Memorandum, Articles and resolutions of the company in general meetings. Thus, a general meeting may, by amending the articles, restrict the powers of the Board. But the meeting cannot invalidate any act validly done by the Board except in the cases: (1) where the directors are either unable or unwilling to act [Barron v. Potter (1914) 1 Ch. 895]; (2) when the directors act for their own personal interests in complete disregard to the company [Marshall's Value Gear Co. Ltd. v. Manning Wardle & Co. Ltd (1909) Ch. 267]; (3) when the Board has become incompetent to act e.g., where all the directors constituting the Board are interested in a dealing or where none of the directors was validly appointed [B.N. Vishwanathan v. Tiffins B.A. and Ltd. AIR (1953) Mad 510].

7.10.1 The Mode or Manner of Exercise of Board's Powers

Section 292 provides that the Board of Directors of a company shall exercise the following powers on behalf of the company and it shall do so only by means of resolutions passed at meeting of the Board: (i) the power to make calls on shareholders in respect of money unpaid on their shares; (ii) the power to issue debentures; (iii) the power to borrow money otherwise than on debentures; (iv) the power to invest funds of the company; and (v) the power to make loans.

The Board may, however, by a resolution passed at a meeting delegate to any committee of directors, the managing directors, the manager or any other principal officer of the company, the powers specified in clauses (iii), (iv) and (v) on such conditions as the Board may prescribe.

Besides the powers specified in Section 292, there are certain other powers also which can be exercised only at the meeting of the board. These are: (i) The power of filling casual vacancies in the Board (Section 262); to appoint additional directors (Section 260); and to appoint alternate directors (Section 313) (ii) sanctioning of a contract in which a director is interested [Section 297] (iii) the power to recommend the rate of dividend to be declared by the company at the Annual General Meeting, subject to the approval by the shareholders.

In the following cases, not only that the powers be exercised at the Board's meeting but also that every director present and entitled to vote must consent thereto: (1) The power to appoint a person as managing director or manager, who is already managing director or manager of another company (Sections 316 and 386). (2) The power to invest in any shares and debentures of any other body corporate (Section 372).

7.10.2 Restrictions on Powers of Directors

Section 293 provides that the Board of Directors of a public company or a private company which is a subsidiary of a public company cannot exercise the following powers without the consent of the shareholders in general meeting:

1. Sell, lease or otherwise dispose of the whole, substantially the whole, of the undertaking of the company, or where the company owns more than one undertaking, of the whole or substantially the whole, of any such undertaking.

   However, this restriction does not apply to the case of a company whose ordinary business is to sell or lease property.

2. Remit or give time for the re-payment of any debt due by a director except in the case of renewal or of continuance of an advance made by a banking company to its director in the ordinary course of business.

3. Invest, otherwise than in trust securities, the amount of compensation received by the company in respect of compulsory acquisition of any fixed assets of the company.

4. Borrow money exceeding the aggregate of the paid-up capital of the company and its free reserves. "Borrowing" does not include temporary loans obtained from the company's bankers in the ordinary course of business.

5. Contribute in any year, to charitable and other funds not directly relating to the business of the company or the welfare of its employees, any amount exceeding ₹50,000 or 5% of its average net profit for the last three financial years, whichever is greater.

However, contributions of National Defence Fund or any other fund approved by the Central Government for the purpose of national defence are exempted from the above provisions. Any amount may be contributed without obtaining the sanction of the company is general meeting.

The Companies Act does not expressly empower companies to borrow money. Therefore, most of the companies expressly provide for such borrowing powers in the memorandum. In such a case, where memorandum authorises the company to borrow, the Articles provide as to how and by whom these powers shall be exercised. It may also fix up the maximum which can be borrowed by the company.

7.11 DUTIES OF DIRECTORS

Duties of directors may be divided under two heads: 1. Statutory duties; and 2. Duties of a general nature. The statutory duties are the duties and obligations imposed by the Companies Act. These have been discussed at appropriate places. Important among them are:

(a) ***To file return of allotments.*** Section 75 charges a company to file with the registrar, within a period of 30 days, a return of the allotments stating the specified particulars. Failure to file such return shall make directors liable as 'officer in default'. A fine upto ₹500 per day till the default continues may be levied.

(b) ***Not to issue irredeemable preferences shares or shares redeemable after 10 years.*** Section 80, forbids a company to issue irredeemable preference shares or preference shares redeemable beyond 10 years. Directors making any such issue may be held liable as 'officer in default' and may be subject to fine upto ₹1,000.

(c) ***To disclose interest (Sections 299-300).*** A director who is interested in a transaction of the company must disclose his interest to the Board. The disclosure must be made at the first meeting of the Board held after he has become interested. This is because a director stands in a fiduciary capacity with the company and therefore, he must not place himself in a position in which his personal interest conflicts with his duty. Interest should be such which conflicts with the duties of the director towards the company.

Notice, however that the Companies Act does not debar a company from entering into a contract in which a director is interested. It only requires that such interest be disclosed An interested director should not take part in the discussion on the matter of his interest. His presence shall not be counted for the purpose of quorum. He shall not vote on that matter. If he does vote, his vote shall be void. Non-disclosure of interest makes the contract voidable and not void. Where the whole body of directors is aware of the facts, a formal disclosure is not necessary (Venkatachalapathi v. Guntur Mills). In this case a loan was advanced by the wife of a director creating a mortgage on the property of the company. The director did not disclose his interest and he even voted on the matter. The company later sued to have mortgage set aside. Held, the fact was known to all directors and a formal disclosure was not necessary. As regards voting by the interested director, it was held that the voting would not render the contract void or voidable unless in the absence of that vote, there would have been no quorum qualified to contract.

(d) ***To disclose receipt from transferee of property.*** Section 319 provides that any money received by the directors from the transferee in connection with the transfer of the company's property or undertaking must be disclosed to the members of the company and approved by the company in general meeting. Otherwise the amount shall be held by the directors in trust for the company. This money may be in the name of compensation for loss of office but in essence may be on account of transfer of control of the company. But if it is bona fide payment of damages of the breach of contract, then it is protected by Section 321(3).

(e) ***To disclose receipt of compensation from transferee of shares.*** If the loss of office results from the transfer (under certain conditions) of all of the shares of the company, its directors would not receive any compensation from the transferee unless the same has been approved by the company in general meeting before the transfer takes place (Section 320) If the approval is not sought or the proposal is not approved, any money received by the directors shall be held in trust for the shareholders who have sold their shares.

Section 320 further provides that in pursuance of any agreement relating to any of the above transfers, if the directors receive any payment from the transferee within one year before or within 2 years after the transfer, it shall be accounted for to the company unless the director proves that it is not by way of compensation for loss of office.

Section 321 further provides that 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 and should be disclosed to the shareholders

Some other statutory duties are, to attend Board meetings; to convene and hold general meetings; to prepare and place before AGM financial accounts; to make declaration of solvency

The general duties of directors are as follows:

(a) ***Duty of Good Faith:*** The directors must act in the best interest of the company. Interest of the company implies the interests of present and future members of the company on the footing that the company would be continued as a going concern.

A Director should not Make any Secret Profits. He should also not exploit to his own use the corporate opportunities. In Cook v. Deeks (1916) AC 554, it was observed that "Men who assume complete control of a company's business must remember that they are not at liberty to sacrifice the interest which they are bound to protect and while ostensibly acting for the company, direct in their own favour

business which should properly belong to the company they represent". In this case there was an offer of a contract to the company. Directors who were the holders of shares of 3/4 of the votes resolved that the company had no interest in the contract and later entered the contract by themselves. Held, the benefit of the contract belonged in equity to the company.

(b) ***Duty of Care.*** A director must display care in performance of the work assigned to him. He is, however, not expected to display an extraordinary care but that much care only which an ordinary prudent man would take in his own case. Justice Romer in *Re City Equitable Fire Insurance Company* observed, "His (director's) duties will depend upon the nature of the company's business, 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 proposition that directors are not liable for mere errors of judgement".

Similar view was expressed in Langunas Nitrate Co. v. Lagunas Nitrate Syndicate (1899) 2 Ch. 392, in the following words: "If directors act within their powers, if they act with such care as is to be reasonably expected of them having regard to their knowledge and experience and if they act honestly for the benefit of the company they discharge both their equitable as well as legal duty to the company".

Section 201 states that a provision in the company's Articles or in any agreement that excludes the liability of the directors for negligence, default, misfeasance, breach of duty or breach of trust, is void. The company cannot even indemnify the directors against such liability. But if a director has been acquitted against such charges, the company may indemnify him against costs incurred in defense. Section 633 further states that where a director may be liable in respect of the negligence, default, breach of duty, misfeasance or breach of trust but if he has acted honestly and reasonably and having regard to all the circumstances of the case, he ought fairly to be excused, the court may relieve him either wholly or partly from his liability on such terms as it may thinks fit.

(c) ***Duty to Attend Board Meetings.*** A number of powers of the company are exercised by the Board of Directors in their meetings held from time to time. Although a director is not expected to attend all the meetings but if he fails to attend three consecutive meetings or all meetings for a period of three months, whichever is longer, without permission, his office shall automatically fall vacant.

(d) ***Duty not to Delegate.*** Director being an agent is bound by maxim 'delegatus non protest delegate' which means a delegate cannot further delegate. Thus, a director must perform his functions personally. A director may, however, delegate in the cases: (a) where permitted by the Companies Act or articles of the company; (b) Having regard to the exigencies of business certain functions may delegated to other officials of the company.

Some other duties are: to convene statutory, annual general meeting and also extraordinary general meeting when required by the shareholders of the company; to prepare and place at the AGM along with the balance sheet and profit and loss account a report on the company's affairs; to make a declaration of solvency in the case of a Member's voluntary winding up.

The duties of the directors are usually regulated by the company's articles. While performing their duties, they must display reasonable care, honesty, good faith, skill and diligence. As they stand in a fiduciary relationship to the company and they are agents and trustees in certain respects, they are bound to exercise in the performance of their duties a reasonable degree of skill and care.

7.12 LIABILITIES OF DIRECTORS

The liabilities of directors may be considered under the following heads: (1) Liability to the company. (2) Liability to third parties. (3) Liability for breach of statutory duties. (4) Liability for acts of co-directors. (5) Criminal Liability.

Liability to the company: The liability to the company may arise from: (a) breach of fiduciary duty; (b) *ultra-vires* acts; (c) negligence; and (d) breach of trust and misfeasance.

(a) ***Breach of Fiduciary Duty:*** Where a director acts dishonestly in disregard to the interests of the company, he will be held liable for breach of fiduciary duty. Most of the powers of directors are 'powers in trust' and therefore, should be exercised in the interest of the company and not in the interest of the directors or any section of members. Thus, where the directors, in order to forestall a take-over bid, transferred the unissued shares of the company to trustees to be held for the benefit of the employees and an interest-free loan from the company was advanced to the trustees to enable them to pay for the shares, it was held to be a wrongful exercise of the fiduciary powers of the directors [Hogg v. Cramphorn Ltd. (1966) 3 All ER 420].

(b) ***Ultra-vires Acts:*** Directors are supposed to act within the parameters of the provisions of the Companies Act, Memorandum and Articles of Association since these lay down the limits to the activities of the company and accordingly to the powers of the Board of Directors. The directors shall be held personally liable for acts beyond the aforesaid limits, being ultra-vires. Thus, where the directors pay dividends or interest out of capital, they will be liable to indemnify the company for any loss or damage suffered due to such act.

(c) ***Negligence:*** The directors shall be deemed to have acted negligently in discharge of their duties and consequently liable for any loss or damage resulting therefrom where they fail to exercise reasonable care, skill and diligence. However, error of judgement will not be deemed as negligence. It may be noted that the directors cannot be absolved of the liability for negligence by any provision in the Articles (Section 201). The court may award relief to directors against such liability under Section 633.

(d) ***Breach of Trust and Misfeasance:*** Directors are the trustees for the money and property of the company handled by them, as well as the exercise of the powers vested in them. If they act dishonestly or *mala fide* in the exercise of their powers and performance of their duties, they will be liable for breach of trust and may be required to make good the loss or damage suffered by the company by reason of such *mala fide* acts. They are also accountable to the company for any secret profits they might have made in transactions on behalf of the company.

Directors can also be held liable for their acts of 'misfeasance', i.e., misconduct or wilful misuse of powers. However, misconduct which is not wilful shall not amount to 'misfeasance'. Moreover, the directors are entitled to relief against liability for breach of trust or misfeasance under Section 633.

Where a director has misapplied or misappropriated money or property of the company or has been guilty of breach of trust or misfeasance, the court may order

him to repay the money or restore the property or to pay compensation [P.K Nedungadi v. Malayalee Bank Ltd., AIR (1971) S.C. 829].

Liability to Third Parties: The discussion on liability of directors towards third parties may be grouped as under: (a) Liability under the provisions of the Act. (b) Liability for breach of warranty of authority.

(a) ***Liability under the Act:*** The following provisions make directors personally liable to third parties. (i) **With regards to prospectus**. Failure to state any particulars as per the requirements nf Section 56 or misstatement of facts in a prospectus renders a director personality liable of damage to the third party. Section 62 provides that as directors shall be liable to pay compensation to every person who subscribes for any shares or debentures on the faith of the prospectus for any loss or damage he may have sustained by reason of any untrue statement included therein. He may, however. escape liability where he proves his innocence. (ii) **With regard to allotment**. Directors may also incur personal liability for–irregular allotment, i.e., allotment before minimum subscription is raised or without filing a copy of the statement in lieu of prospectus [Section 71(3)] – for failure to repay application money in case of minimum subscription having not been received [Section 69(5)] – for failure to repay application money when application for listing of securities is not made or is refused (Section 73). (iii) ***Unlimited liability:*** Directors will also be held personally liable to the third parties where their liability is made unlimited in pursuance of Section 322 (i.e., vide memorandum) or Section 323 (i.e., vide alteration of memorandum by passing special resolution). (iv) ***Fraudulent trading:*** Directors may also be made personally liable for the debts or liability of a company by an order of the court under Section 542. Such an order shall be made by the Court where directors have been found guilty of fraudulent trading.

(b) ***Liability for breach of warranty:*** Directors are supposed to function within the scope of their authority. Thus, where they transact business in respect of matters ultra-vires the company or ultra-vires the Articles, they may be proceeded against personally for any loss sustained by the third party.

Liability for Breach of Statutory Duties: The Act, imposes numerous statutory duties on the directors under its various sections. Default in compliance of these duties attracts penal consequences. For instance, they are liable as 'officer-in-default' for default in filing return of allotments (Section 75), for failure to comply with the provisions of the Act relating to issue of redeemable preference shares or redemption of irredeemable preference shares, etc. (Section 80, 80A).

Liability for acts of co-directors: A director is the agent of the company and not of the other members of the Board. Accordingly, nothing done by the Board can impose liability on a director who did not participate in their action or did not know it. His liability shall not arise even where he attends the subsequent Board meeting at which minutes recording the wrongful action of the earlier meeting are confirmed. To incur liability he must either be a party to the wrongful act or later acquiesce (consent) to it. Thus, the absence of a director from Board meetings does not make him liable for the fraudulent acts of a co-director on the ground that he ought to have discovered the fraud [Dovey v. Cory (1884) 25 Ch. D. 725].

Where a director is made liable for the acts of co-director he is entitled to contribution from the other director or co-director who were a party to the wrongful act [Ramskil v. Edwards (1885) 31 Ch.D.100]. However, where the director seeking contribution alone benefited from the wrongful act, he is not entitled to contribution.

Criminal Liability: Apart from civil liability under the Act or under the general law, directors of a company may also incur criminal liability under common law, as well as

under the Companies Act and other statutes. Some of the provisions of the Companies Act which make directors criminally liable (fine or/and imprisonment) are.

Section 44(4) – Filing of prospectus or statement in lieu of prospectus (to be filed by private company on ceasing to be private company) containing untrue statement.

Section 58A(5) – Failure to repay deposits within the prescribed time limits.

Section 58A(6) – Accepting deposits or inviting deposits in excess of the prescribed limits.

Section 63 – Issuing a prospectus containing untrue statement.

Section 68 – Knowingly making a false, deceptive or misleading statement and thereby inducing persons to invest money.

Section 84(3) – Fraudulently renewing a share certificate or issuing a duplicate certificate.

Section 210(5) – Failure to lay balance-sheet, profit & loss accounts, etc. at the annual general meeting.

Section 240(3) – Failure or refusal to produce books to inspector or furnish information or to appear before inspector conducting investigation.

Section 295(4) Granting loan to directors without approval of the Central Government.

Criminal liability under SEBI. The directors of a company may also be held criminally liable for contravention of the provision of SEBI.

Criminal liability under economic legislations. Directors are also made criminally liable for various lapses and non-compliances under MRTP Act, I(D&R) Act, FEMA, Income tax Act, etc.

Check Your Progress

Fill in the blanks:

1. Every public company must have atleast _____directors. Every private company must have atleast _____directors.
2. In the case of a trust, the legal ownership of the trust property is transferred to the _____and therefore, he can enter into contract in his own name, but whatever he does, he does for the benefit of the beneficiaries.
3. A company in general meetings may, by ordinary resolution, _____the number of its directors within the limits fixed in that behalf by its articles.
4. A person cannot hold office at the same time as a director in more than _____companies.
5. A private company which is not a subsidiary of a _____may, by its Articles, provide additional qualifications for a director, such as, a person must be a B. Com. or holding a fixed deposit receipt in his own name issued by the company.

7.13 LET US SUM UP

- Directors are the persons who direct, conduct, manage or superintend a company's affairs. Directors act as agents of the company and the ordinary rules of agency apply.
- Every public company must have at least three directors. Every private company must have atleast two directors (Section 252).
- A company in general meetings may, by ordinary resolution, increase or reduce the number of its directors within the limits fixed in that behalf by its articles (Section 258).
- No body corporate, association or firm shall be appointed director of any company. Only an individual can be a director (Section 253).
- A person cannot hold office at the same time as a director in more than twenty companies (Section 275).
- The Act has not prescribed any academic or professional qualifications for the directors.
- Section 284 provides that company may by ordinary resolution passed in general meeting after special notice, remove a director before the expiry of his term of office.
- Section 2(26) defines 'managing director' as a 'director' who, by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him.
- In many sections of the Companies Act, the term 'Whole time Director' has been used side by side with that of the 'managing director'.
- The appointment of directors rests in the following hands: (a) Subscribers to the Memorandum (b) Company in general meeting (c) Board of directors (d) Central Government (e) Third parties.
- An individual must be in charge of the whole or substantially the whole of the business of the company, in order to be called a manager in accordance with the Act.
- The directors of a company are collectively known as Board and decisions are taken by them at a Board meeting.
- Duties of directors may be divided under two heads: 1. Statutory duties; and 2. Duties of a general nature.
- The liabilities of directors may be considered under the following heads: (1) Liability to the company. (2) Liability to third parties. (3) Liability for breach of statutory duties. (4) Liability for acts of co-directors. (5) Criminal Liability.

7.14 LESSON END ACTIVITY

Discuss the following cases with your classmates:

1. The Board of Directors of a public company met on three times in the previous year, the fourth meeting though called, but not held for want of quorum on two occasions successively. Discuss whether any provisions of the Companies Act have been contravened.

2. X Co. Ltd., wants to make a contract with a partnership. Four of the five directors of the company are partners of such partnership. How can the contract be executed?

7.15 KEYWORDS

Director: A director is any person occupying the position of director, by whatever name called.

Office or Place of Profit: A director is deemed to hold an office or place of profit under the company if the director holding an office obtains from the company anything by way of remuneration over and above the remuneration to which he is entitled as such director.

Managing Director: He is 'director' who by virtue of an agreement with the company or of a resolution passed by the company in general meeting or by its Board of Directors or, by virtue of its memorandum or articles of association, is entrusted with substantial powers of management which would not otherwise be exercisable by him.

Manager: He is an individual who, subject to the superintendence, control and direction of the board of director, has the management of the whole, or substantially the whole of the affairs of the company, and includes a director or any other person occupying the position of a manager, by whatever name called and whether under a contract of service or not.

Secretary: A secretary is defined as a company secretary within the meaning of the Company Secretaries Act, 1980 and includes any other individual possessing the prescribed qualifications and appointed to perform the duties which may be performed by a secretary under the Companies Act and any other ministerial or administrative duties.

7.16 QUESTIONS FOR DISCUSSION

1. Are company director's trustees or agents of the company? Explain.
2. How is a director (i) appointed and (ii) removed from office?
3. What are the disqualifications of a person for appointment as the director of a company?
4. State in relation to a public company: (i) When additional directors can be appointed and for what period? (ii) When an alternate director can be appointed and for what period? (iii) How the office of a director is filled in case of a casual vacancy and for what period?
5. When can board of directors appoint directors?
6. State the circumstances under which a director would vacate office.
7. Total strength of the board of directors of a company is ten. How many directors are liable to retire by rotation at the next annual general meeting?
8. When can directors be appointed by the principle of proportional representation under section 265? (a) What do you understand by an office or place of profit held by a director in a company? (b) What restrictions have been imposed in respect of holding an office or place of profit by a director?
9. State the requirements of the companies act with respect to contracts in which particular directors are interested.

10. How many meetings of a board of directors of a company must be held in a year and at what intervals?
11. Define managing director and state the statutory provisions regarding his appointment and remuneration.
12. What are the powers of directors that cannot be exercised without the approval of members given in a general meeting?
13. Distinguish between a managing director and a wholetime director.
14. Discuss the powers of the central government to remove the managerial personnel on a reference made to the CLB.
15. Write short notes on: (i) alternate director (ii) managerial remuneration.

Check Your Progress: Model Answer

1. Three, two
2. Trustee
3. Increase or reduce
4. Twenty
5. Public company

7.17 SUGGESTED READINGS

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LESSON

8

COMPANY-MEETINGS

CONTENTS

8.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Identify the types of meetings
- Discuss the statutory meeting
- Explain the annual general meeting
- Discuss the extra-ordinary general meeting
- Discuss the matters relating to general meetings

8.1 INTRODUCTION

A company is an artificial person and therefore, cannot act itself. It must act through some human intermediary. The various provisions of law empower shareholders to do certain things.

They are specifically reserved for them to be done in company's general meetings. Section 291 empowers the Board of Directors to manage the affairs of the company. In this context meetings of shareholders and of directors becomes necessary. In this Part meetings of shareholders are taken up and later in Part 14, meetings of directors are discussed.

8.2 TYPES OF MEETINGS

The Act has made provisions for different types of meetings of shareholders:

(i) Statutory Meeting;

(ii) Annual General Meeting;

(iii) Extraordinary General Meeting; and

(iv) Class Meetings.

Let's study these types in detail in below section.

8.3 STATUTORY MEETING (SECTION 165)

Some of the most important legal provisions regarding the statutory meeting are:

(i) It is required to be held only by a public company having a share capital. A private company or a public company registered without share capital is under no obligation to hold such a meeting.

(ii) It must be held within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business.

(iii) Atleast 21 days before the day of meeting, a notice of the meeting is to be sent to every member stating it to be a Statutory Meeting.

(iv) The Board of Directors should also get a report, called the Statutory Report, sent to each member along with the notice of the meeting. If the statutory report is forwarded later, it shall be deemed to have been duly forwarded if it is so agreed to by *all the members* entitled to attend and vote at the meeting. A copy of the Statutory Report should also be sent to the Registrar after the same is sent to the members.

The Statutory Report contains (a) the total number of shares allotted – fully paid-up and partly paid-up: allotted for cash and for consideration other than cash; (b) the total cash received by the company in respect of all allotments; (c) an abstract of receipts and payments up to a date within seven days of the date of the Report and the balance of cash in hand; (d) any commission or discount paid on the issue of shares or debentures, (e) the names, addresses and occupations of directors, auditors, managers and the secretary of the company; (f) the extent to which any underwriting contract has not been carried out; (g) the arrears due on calls from every director; (h) the particulars of any commission or brokerage paid to any director or manager on the issue of shares and debentures.

The Statutory Report is required to be certified as correct by atleast two directors, one of whom shall be the managing director, where there is one. Also, the auditors of the company shall certify that part of the Statutory Report which relates to the shares allotted, cash received thereon and the receipts and payments and the balance of cash in hand.

(v) The members present at the meeting may discuss any matter relating to the formation of the company or arising out of the statutory report without previous notice having been given.

(vi) The meeting may adjourn and the adjourned meeting has the same powers as the original meeting. The adjourned meeting, therefore, may do anything which could have been done by the original meeting.

(vii) If default is made in complying with the provisions of Section 165, the following consequences may follow: (a) Every director or other officer of the company who is in default shall be punishable with fine upto ₹5,000; (b) The Registrar or a contributory may apply to the Court for the winding up of the company [Section 439]. However, the Court may, instead of passing an order for winding up, give directions for the holding of the meeting or filing of the Statutory Report.

(viii) It should be remembered that this meeting is required to be held only once in the life time of a public company, having a share capital.

8.4 ANNUAL GENERAL MEETING (AGM) (SECTIONS 166-168)

As the name signifies, this is an annual meeting of a company. The provisions relating to this meeting are:

Every company, whether public or private, having a share capital or not, limited or unlimited must hold this meeting.

The meeting must be held in each calendar year and not more than fifteen months shall elapse between two meetings. However, the first AGM may be held within eighteen months from the date of its incorporation and if such general meeting is held within that period, it need not hold any such meeting in the year of its incorporation or in the following year. The maximum gap between two such meetings may be extended by three months by taking permission of the Registrar, who may so allow for any special reason.

The Company Law Department has expressed the view that the Registrar can grant extension of time, for special reasons, upto a maximum period of 3 months, even if such extension allows the company to hold its AGM beyond the calendar year. However, the said extension shall be granted only if the application therefore is made to the Registrar before the expiry of the period as per Section 166 (1).

The meeting must be held (i) on a day which is not a public holiday, (ii) during business hours, (iii) at the registered office of the company or at some other place within the city, town or village in which the registered office is situated. [Section 166(2)].

The business to be transacted (Section 173) at such a meeting may comprise of:

(i) Ordinary business which relates to the following matters: (a) consideration of accounts, balance sheet and the reports of the Board of Directors and Auditors; (b) declaration of dividend; (c) appointment of directors in the place of those retiring; and (d) appointment of auditors and fixation of their remuneration. (ii) Any business other than ordinary business transacted at the meeting will be deemed to be special business. With regard to all special business, an Explanatory Statement is required to be annexed to the notice.

What about a situation where annual accounts are not ready for being placed before the AGM? In case annual accounts are not ready for laying at the appropriate AGM, it is open to the company concerned to adjourn the said AGM to a subsequent date when the annual accounts are expected to be ready for laying. Since consideration of annual accounts is only one of the matters to be dealt with at an AGM, directors are under a statutory obligation to hold the meeting. The proper course shall be to hold the

meeting and then adjourn it to a suitable date for considering the accounts. The adjourned meeting must, however, be held within the maximum time limit allowed under Section 166.

The combined reading of Sections 166 and 210 requires compliance with the following: (a) There must be one meeting held in each calendar year. (b) Not more than 15 months must elapse between one general meeting and another. (c) The period of 15 months may be extended to 18 months by the Registrar. (d) Except in the case of the first AGM, the accounts must relate to a period beginning with the day immediately after the period for which they were submitted and ending with a day which must not precede the day of the meeting by more than 6 months; or 6 months and the extension granted by the Registrar, i.e., a maximum period of 9 months.

The company must give twenty-one days' notice to all the members of the company and the auditor. A shorter notice may be held valid if consent is accorded to by all the members entitled to vote at the meeting (Section 171). Such a consent may be given before the meeting is held or after the resolutions are passed. A copy of directors' report on the company's position for the year together with copy of the audited accounts and auditors' report must accompany the notice. Also a proxy form must be attached with the notice, on which it shall be specifically mentioned that a member entitled to vote is entitled to appoint Proxy, and Proxy need not be a member of the company.

The notice must specify the place and the day and hour of the meeting and shall contain a statement of the business to be transacted thereat [Section 172(1)].If the time of holding the meeting and other essential particulars required by the section are not specified in the notice, the meeting will be invalid and all resolutions passed thereat will be of no effect.

The notice must be given to every member, legal representative of a deceased member or assignee of an insolvent member and to auditor or auditors [Section 172(2)].

If default is made in holding the meeting, the Central Government may, on the application of any member of the company, call or direct the calling of the meeting. If the company fails to hold the meeting either originally or when directed to do so by the Central Government, then the company and every officer of the company who is default shall be punishable with fine upto ₹50,000; and in the case of a continuing default, with a further fine of ₹2500 per day during the continuance of default (Section 168).

8.4.1 Certain Typical Issues in Respect of AGM

Whether AGM can be called on a public holiday. Section 166(2), inter alia, provides that every AGM shall be called on a day that is not a public holiday. The Department of Company Affairs has opined that it is a mandatory provision.

However, bank holidays (for purposes of closing) though declared as public holidays under the Negotiable Instruments Act, 1881 shall not be treated as public holidays for the aforesaid purpose. Thus, 31st March and 30th Sept. shall not be considered as public holidays.

In the following cases, however, AGM may be held on a public holiday: (i) Section 2(38) provides that if any day is declared by the Central Government to be a public holiday after the issue of the notice convening such a meeting, it shall not be deemed to be a public holiday in relation to the meeting. (ii) Where a public company or its subsidiary has by its articles fixed the time of its AGM and the day turns out to be a public holiday [*Proviso* (a) to Section 166(2)]. (iii) Where a public company or its subsidiary has by a resolution passed in one AGM fixed the time for its subsequent

AGM and the day turns out to be a public holiday [*Proviso* (a) to Section 166(2)]. (iv) A private company which is not a subsidiary of a public company may also [like a public company or its subsidiary under (ii) and (iii) above] by a resolution agreed to all the members thereof fix the time as well as the place of its AGM and the same shall be valid if the day happens to be a public holiday [*Proviso* (b) to Section 166(2)] (v) A company to whom a licence is granted under Section 25 is exempted from the provisions of Section 166(2). (vi) Where the AGM is adjourned because of lack of quorum, it is to be held on the same day in the next week at the same time and place (Section 174). In case the day comes to be accidentally a public holiday, it shall not amount to contravention of Section 166(2).

It is not obligatory to advertise notice of meetings in the newspapers. However, as an abundant precaution, the company may advertise in the newspapers to avoid objection from such of the shareholders as reside outside India and who incidentally may not receive the notices served through post.

Voting rights of members shall be determined as at the date of the meeting and not as they would/have been if the meeting had been held within the prescribed time.

A meeting beyond statutory time cannot be said to be void or illegal. If the Tribunal does not extend the date of holding the AGM u/s 167, the Directors shall be subjected to increasing penalty but the meeting shall be a valid meeting. Otherwise, the position in law would become impossible.

The Board of Directors has the power to cancel or postpone a meeting convened, though it cannot be exercised except for bona fide and proper reasons

8.5 EXTRA-ORDINARY GENERAL MEETING (EGM) (SECTION 169)

Clause 47 of Table A (Schedule I) provides that all general meetings other than AGMs shall be called the EGMs. The legal provisions as regards such meetings are:

EGM is convened for transacting some special or urgent business that may arise in between two AGMs, for instance, change in the objects or shift of registered office or alteration of capital. All business transacted at such meetings is called special business. Therefore, every item on the agenda must be accompanied by an 'Explanatory Statement'.

An EGM may be called: (i) by the Directors of their own accord; (ii) by the Directors on requisition; (iii) by the requisitionists themselves; (iv) by the CLB. The Board of Directors may call a general meeting of the members at any time by giving not less than 21 day's notice. A shorter notice may, however, be held valid if consent is accorded thereto by members of the company holding 95% or more of the voting rights (Section 171). The Board of Directors must convene a general meeting upon request or requisition if the following conditions are satisfied (Section 169).

The requisitionists must be such number of members who, at the date of the deposit of the requisition, are the holders of 1/10th of total voting power. Thus, in case of a company having share-capital they should hold atleast 1/10th of such of the paid-up capital that carries right to vote in regard to that matter. Preference shareholders have voting power only as regards matters relating to the preference shareholders. They have no voting right and therefore, no right to requisition in respect of other matters. If the company does not have a share capital, they should atleast hold 1/10th of the total voting power of the company in regards to that matter. The requisition must state the objects of the meeting, i.e., it must set out the matters for the consideration of which the meeting is to be called. Further, requisition must have been deposited at the registered office of the company. The requisition must be signed by the requisitionists.

In case all the aforesaid conditions are satisfied, the Board of Directors must within 21 days of the receipt of the requisition call the meeting giving atleast 21 day's notice fixing the meeting within 45 days of the receipt of the requisition.

Where the resolution proposed is a special resolution then the requirements of Section 189(2) must be complied with, viz., it should be so described and explanatory statement be annexed.

If the Board of Directors does not or fails to call the meeting as aforesaid (i.e., within 21 days fixing the date of the meeting within 45 days of the deposit of a valid requisition), the meeting may be called: by the requisitionists themselves: (a) In case of a company having share capital, by one or more requisitionists as represent: (i) a majority in value of the paid-up share capital held all the requisitionists; or (ii) atleast 1/10th of the paid-up share capital carrying voting rights in respect of that matter, whichever is less; or (b) in case of a company not having share capital, by one or more requisitionists who represent atleast 1/10th of the total voting power of the company in regard to the matter of the requisition.

Where the Articles, in accordance with the provisions of Section 180, provide that members who have not paid calls on their shares would not be entitled to vote. them they cannot requisition a meeting, nor vote it and if they do so the proceedings would be invalid.

The requisitioned meeting must be held within 3 months of the date of the deposit of the requisition. Further, where two or more persons hold any shares or interest in a company jointly, a requisition, or a notice calling a meeting, signed by one or some only of them shall, for the purposes of this section, have the same force and effect as if it had been signed by all of them.

Any reasonable expenses incurred by the requisitionists, as aforesaid, shall be repaid to them by the company and the same shall be recouped from directors at fault.

Meeting by the requisitionists must be held in the same manner as nearly as possible, in which the meetings are to be called by the Board. However, where the registered office is not made available to them for holding the meeting, they may hold the meeting elsewhere [R. Chettair v. M. Chettair (1951) 21 Comp. Cas. 93].

Powers of the Company Law Board (Section 186): If for any reason it is impracticable to call a meeting of the company, other than an AGM, the Company Law Board may direct the calling of the meeting: (a) on its own motion; (b) on an application of any director; (c) on an application of any member entitled to vote at that meeting.

For the aforesaid meeting, the Company Law Board may give directions in respect of the place, date and the manner in which the meeting be held and conducted. It may also give such ancillary or consequential directions as it thinks expedient, including a direction that one member present in person or proxy shall be deemed to constitute a meeting.

8.5.1 Class Meetings (Section 107)

When it is proposed to alter, vary or affect the rights of a particular class of shareholders (e.g., where accumulated dividends on cumulative preference shares is to be cancelled) and it is not possible to obtain the consent in writing, of the holders of 3/4ths of the issued shares of that class, a meeting of the holders of those shares may be called. Such a meeting is commonly known as a 'class meeting'. It should be noted that all resolutions in a class meeting must be passed as special resolutions.

The holders of atleast 10 percent of the issued shares of that class who did not consent in favour of the resolution may apply to the Court within 21 days to have the resolution cancelled and where such application is made, the resolution shall not have effect unless and until it is confirmed by the Court.

8.6 MATTERS RELATING TO GENERAL MEETINGS

Notice of the Meeting (Section 171): Every member of the company is entitled to a notice of every general meeting. A notice of not less than 21 days must be given in writing to every member. However, a shorter notice for AGM will be valid if all members entitled to vote give their consent. In case of other meetings, a shorter notice will be valid if consent is given by members holding atleast 95 percent of the paid-up capital carrying voting rights, or representing atleast 95 percent of the voting power.

The notice may be given to members either personally, or sending by post to him at his registered address. A notice of a meeting may also be given by advertising the same in a newspaper circulating in the neighbourhood of the registered office of the company.

The secretary should see that proper notice of meeting must be given to all persons who are entitled to receive it. An improper or insufficient notice, as well as absence of notice, may affect the validity of a meeting and render the resolutions passed at the meeting ineffective. Also the notice should make a full and frank disclosure to the members of the fact on which they would be expected to vote.

Agenda of the Meeting: The word 'agenda' indicates the business to be transacted at a meeting. It is prepared for all kinds of meetings in order that the meeting may be conducted systematically. The agenda is generally prepared by the secretary in consultation with the chairman. It is drafted in such a manner as to help the chairman to conduct the meeting smoothly. In drafting the agenda, the secretary should bear in mind the following: (i) the agenda should be clear and explicit; (ii) it should be drafted in a summary manner; (iii) all items of routine business should be put down first and the contentious matters later; and (iv) all items of similar nature should be placed in a continuous order.

The foregoing points are important because when a copy of the agenda is sent to a member, he is in a position to form a definite opinion of the subject matter to be discussed at the meeting. While preparing the agenda, care should be taken for the order of the matters to be discussed, as the order of the agenda cannot be altered except with consent of the meeting. Sometimes, the agenda is drafted in such a manner that it can serve the purpose of minutes later on. Some space is left opposite each agenda item and the secretary writes it up during the meeting; this practice is very common in the preparation of agenda for Board meetings.

Sometimes, companies maintain an Agenda Book, wherein the agenda items are entered. It is placed before the chairman of the meeting and is regarded as the agenda. Those placed before the members or other directors are copies only. Later, the Agenda book becomes a permanent record for future reference.

Proxy (Section 176): In the case of a company, every member of a company entitled to attend and vote at a meeting has the right to appoint another person, whether a member or not, to attend and vote for him. The term proxy is applied to the person so appointed. Also, it refers to the instrument by which a member of a company appoints another person to attend the meeting and vote on his behalf. However, the proper term for this document is proxy form or proxy paper. The following points about proxies are to be noted: (i) A proxy has no right to speak at the meeting. (ii) A proxy need not be a member of the company. (iii) The instrument appointing a proxy must be in

writing and signed by the appointed. (iv) The proxy form must bear the date of the meeting. (v) No company can make it compulsory for any one to lodge proxies earlier than 48 hours before the meeting. (vi) A proxy may be revoked before the person appointed has voted. (vii) A proxy can demand a poll. (viii) A proxy cannot vote against the wishes of his appointer.

Secretarial Work as Regards Proxies: (a) Scrutinise the proxy forms to see whether they comply with the provisions the Act, and the bye-laws and rules of the organisation. (b) Any proxies received after the stipulated time limit must be returned with a note that they cannot be accepted. (c) Any irregularities in proxy forms should be reported to Chairman of the meeting, as he is the final authority to accept or reject them. (d) Each correct proxy form is countersigned by the Secretary. (e) Enter the correct proxy forms in Register of proxies. (f) Return the proxy form to the member together with an Admission card in the name of the proxy.

8.6.1 Quorum for Meeting

A number of members of anybody sufficient to transact business at a meeting are a quorum. Stated differently, a quorum is the minimum number of persons whose presence is necessary for the transaction of business. The quorum for meetings is generally fixed by the Articles of the company, or bye-laws and the rules of the association or society. Any resolution passed without a quorum is invalid. In fact, if no quorum is present, then there is no meeting and the proceedings are invalid.

Section 174 provides that unless otherwise so provided in the Articles, in the case of a public company, the quorum is five members personally present and in the case of a private company, it is two members personally present. If Quorum is not present within ½ hour, the meeting shall be adjourned to the same day next week at the same time and place. The Board may determine some other time, day and place but it should be within the town, city or village of the registered office.

Quorum – Certain Typical Issues

1. Can a single member present constitute a valid quorum? A single member present cannot by himself constitute a valid quorum except where the Act expressly so provides (vide Sections167 and 186). Thus, where the meeting is convened by Central Government/Tribunal/s 167 or 186. it may give any directions including a direction that a single member present in person or proxy shall constitute a valid meeting.
2. Presence of Preference Shareholders – whether to be counted for quorum. If business proposed to be transacted at a general meeting does not include any item or resolution proposed to be passed, which directly affect the rights of the preference shareholders, their presence should not be taken into account for purpose of determining the quorum, but where the subject matter includes any resolution in which the rights of preference shareholders are directly affected, their presence should be taken into account for the purpose of the quorum.

8.6.2 Voting (Ascertaining the Sense of the House)

Unanimity on all matters before a meeting is always not obtained. In the absence of unanimity, the chairman wants to know the wishes of the persons present therein. This is known as ascertaining the sense of the house and for this purpose, he has to put the matter before the house to the members. There are various methods which can be adopted by the chairman to put the matter to vote in order to ascertain the wishes of the members. They are as follows: (i) By acclamation, (ii) By voice vote, (iii) By division, (iv) By show of hands, (v) By ballot and (vi) By poll.

(i) ***By Acclamation.*** When persons present in a meeting indicate their approval or disapproval of the motion by clapping of hands, cheering or applause, it is known as voting by acclamation. This method is adopted where there is a unanimous approval or disapproval. For example, the motion of thanks to the chair is generally adopted by this method. But this method should not be adopted if there is a sharp difference of opinion among the members on the issue before them.

(ii) ***By Voice Vote.*** In this case, the Chairman puts the proposition before the meeting and persons who are in favour of the proposition say 'yes' and those who are against it say 'no'. The Chairman hears both the voices 'yes' and 'no' and gives his decision after ascertaining the numbers of 'yes' and 'no'. At this stage, a member who is dissatisfied with the Chairman's decision on the basis of voice vote may demand a vote by show of hands.

(iii) ***By Division.*** Under this method, the Chairman requests the members present in the meeting to divide themselves into two blocks – one in favour of the proposal and another against it. The Chairman, with the help of the Secretary, counts the number of persons in favour and against the proposal and gives his verdict.

(iv) ***By Show of Hands.*** Under this method, the Chairman asks all those in favour of the resolution to raise their right hand and when that number is noted, asks all those against to do likewise. The Chairman then declares the result of the voting indicating whether the proposal has been carried or lost.

(v) ***By Ballot.*** Under this method, every person present records his vote on a ballot paper and deposits it in the ballot box provided for that purpose. The counting of ballots cast for and against the motion reveals the results. This method ensures secrecy in casting votes.

(vi) ***By Poll.*** In company meetings, voting by poll is according to the number of shares held by a member. The voting by show of hands may not always reflect the opinion of members upon a value basis. Also, there may be a number of proxies who can vote only by poll and not by show of hands.

Rules in Respect of Voting. As per the provisions of the Act, rules regarding voting may be noted as follows:

(i) Every holder of equity shares shall have a right to vote [Section 87(1)].

(ii) Right of an equity shareholder to vote cannot be prohibited on the grounds that he has not held his shares for any specified period before the meeting or on any other ground (Section 182). In Ananthalakshmi v. H. I. & F. Trust, AIR 1951 Mad. 927, a provision in the articles of a company that only those shareholders would be entitled to vote whose names have been there on the register for two months before the date of the meeting was held to be in contravention of the Act.

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 (Section 181).

(iii) A preference shareholder shall have the right to vote only on resolutions which directly affect the rights attached to his preference shares [Section 87(2)].

Where the directors proposed to increase the shares of the company by issue of further equity shares, by capitalising an amount standing to the credit of the company's reserve account and applying the same in paying-up the new equity shares and distributing the same as fully paid among the equity shareholders, the proposed resolution was held to affect the rights of the preference shareholders and could, therefore, be only carried out with their sanction [Re John Smith's Tadcaster Brewery Co. Ltd. (1952) 2 All ER 751].

However, rights of preference shareholders are not 'affected' by the issue of additional ordinary shares, though their voting rights are thereby weakened [White v. Bristol Aeroplane Co. Ltd. (1953) I All ER 40 (CA)].

(iv) Voting rights of a member are not affected by the fact that his shares have been attached or pledged or a receiver has been appointed [Balkrishnan Gupta v. Swadeshi Polytex Ltd. (1985) 58 Comp Cas. 563].

(v) Voting to be by show of hands in the first instance. Section 177 provides that at any general meeting, a resolution put to vote shall, unless a poll is demanded under Section 179, be decided on a show of hands. A declaration by the chairman that on a show of hands, a resolution has or has not been carried either unanimously or by a particular majority and an entry to that effect in the Minutes Book of the company, shall be conclusive evidence of the fact. No proof of the number or proportion of the votes cast in favour of or against such resolution shall be required (Section 178).

Demand for Poll. Section 179 provides that before or on declaration of the result of the voting on any resolution on a show of hands, a poll may be ordered to be taken by the Chairman of the meeting of his own motion and shall be ordered to be taken by him on a demand made in that behalf by the person or persons specified below:

(a) In the case of a public company having a share capital, by any member or members present in person or by proxy and holding shares in the company: (i) which confer a power to vote on the resolution not being less than 1/10th of the total voting power in respect of the resolution; or (ii) on which an aggregate sum of not less than fifty thousand rupees has been paid-up;

(b) In the case of a private company having a share capital, by one member, present in person or by proxy if not more than seven members are personally present and by two members present in person or by proxy, if more than seven members are personally present;

(c) In the case of any other company, by any member or members present in person or by proxy and having not less than 1/10th of the total voting power in respect of the resolution.

The chairman of the meeting may regulate the manner in which the poll should be taken. He must appoint two scrutinisers to scrutinise the votes given on the poll and to report thereon to him. Then the chairman will declare the result.

Voting by Companies and Government as Members (Sections 187-187-A): Where a company or a corporation is a member of another company, it may attend the meetings of the other company through a representative. The representative must be appointed by a resolution of the Board of Directors or the other governing body. Where the Central Government or a State Government is a member, the President or the Governor of the State, as the case may be, has the power to appoint representatives to attend meetings of the company. The person nominated shall hold the position of a proxy.

8.6.3 Motions, Resolutions and Amendments

Decisions of a company are taken by resolution of its members, passed at their meetings. Also, the Board of Directors takes certain decisions at its meeting by passing certain resolutions after due deliberations.

The term 'motion' indicates a proposition made at a meeting by any member. Such a motion may be passed without any change or modification. But if some members feel that the motion in the form proposed needs some change or modification, they may

move an amendment. A motion when passed with or without amendment is called a resolution.

A motion should always be in writing and before it is brought before the meeting, the necessary notice must be given. A person proposing a motion is called the mover and the motion should be signed by him.

Once the motion has been put to the members and they have voted in favour of it, it becomes a resolution. In the case of a company, there are three kinds of resolutions: (i) ordinary resolution; (ii) special resolution; (iii) resolution requiring special notice.

Ordinary Resolution (Section 189(1)): When a motion is passed by simple majority of the members voting at a general meeting, it is said to have been passed by an ordinary resolution. In other words, votes in favour of the resolution are more than 50 percent. Still in other words, a resolution shall be an ordinary resolution where the votes cast in favour of the resolution are more than the votes cast against the resolution. According to Section 189(1), "A resolution shall be an ordinary resolution when at a general meeting of which the notice required under the Act has been duly given, the votes cast (whether on show of hands, or on poll, as the case may be), in favour of the resolution (including the casting vote, if any, of the chairman) by members who, being entitled to do so, vote in person or where proxies are allowed, by proxy, exceed the votes, if any, cast against the resolution by members so entitled and voting".

All matters which are not required either by the Act or the company's articles to be done by a special resolution can be done by means of an ordinary resolution. Some of the cases in which only ordinary resolution is required are: alteration of authorised capital, declaration of dividend, appointment of auditors, election of directors, etc.

Special Resolution (Section 189 (2)): A resolution is a special resolution in regard to which: (a) the intention to propose the resolution as a special resolution has been specifically mentioned in the notice calling the general meeting, (b) 21 days notice has been duly given for calling the meeting; (c) the number of votes cast in favour of the resolution is three times the number cast against it.

Some of the cases in which a special resolution is necessary: alteration of objects clause; change of registered office from one State to another; alteration of the Articles; changes in the name of the company; reduction of share capital.

Resolution Requiring Special Notice (Section 190): Some resolutions require special notice. The object of special notice is to give the members sufficient time to consider the proposed resolution and also to give the Board of directors an opportunity to indicate views, on the resolution if it is not proposed by them but by some other shareholders. Under this, a notice of intention to move the resolution should be given to the company not less than 14 days before the date of the meeting at which it is proposed to be moved. The company in turn must immediately give notice by advertisement in a newspaper or in any other mode allowed by the Articles, but not less than seven days before the meeting. Some of the cases in which a special notice is necessary are, appointing an auditor, a person other than a retiring auditor; moving a resolution that a retiring auditor will not be re-appointed; removing a director before his term expires.

Section 192 requires that a printed or a type written copy of each special resolution should be sent to the Registrar within 30 days thereof.

Passing of Resolutions by Postal Ballot (Section 192A): Section 192A contains following provisions for passing of resolution by postal ballot:

(i) A listed company may and in the case of resolution relating to such business as the Central Government may, by notification, declare to be conducted only by postal ballot, shall, get any resolution passed by means of a postal ballot, instead of transacting the business in general meeting of the company.

(ii) Where a company decides to pass any resolution by resorting to postal ballot, it shall send a notice to all the shareholders, along with a draft resolution explaining the reasons therefore and requesting them to send their assent or dissent in writing on a postal ballot within a period of 30 days from the date of posting of the letter.

(iii) The notice shall be sent by registered post acknowledgement due, or by any other method as may be prescribed by the Central Government in this behalf and shall include with the notice, a postage pre-paid envelope for facilitating the communication of the assent or dissent of the shareholder to the resolution within the said period.

(iv) If a resolution is assented to by a requisite majority of the shareholders by means of postal ballot, it shall be deemed to have been duly passed at a general meeting covered in that behalf.

(v) If a shareholder sends under (2) above his assent or dissent in writing on a postal ballot and thereafter any person fraudulently defaces or destroys the ballot paper or declaration of identify of the shareholder, such person shall be punishable with imprisonment for a term which may extend to 6 months or with fine or with both.

(vi) If a default is made in complying with provisions in (1) to (4), the company and every officer of the company, who is in default shall be punishable with fine which may extend to ₹ 50,000 in respect of each such default.

Circulation of Members' Resolution (Section 188): When some members of a company want (i) to propose a resolution at the company's next AGM; or (ii) desire to circulate to members any statement with respect to the matter referred to in any proposed resolution or any business to be dealt with at any general meeting, the Act allows them to use the administrative machinery of the company for the purpose.

If the requisite number of members makes a requisition as aforesaid, the company shall be bound to: (i) give a notice of the resolution intended to be moved at the next AGM; (ii) circulate the statement among the members entitled to notice of any general meeting. However, before the obligation of the company, in respect of the above may arise, the following conditions shall have to be satisfied:

1. ***The requisition must have been Signed by atleast:*** (a) members having 1/20th is to be at one place of the total voting rights of all the members having the right to vote on the resolution; or (b) members, numbering 100 (having the right to vote at the resolution) and commanding a paid-up share capital of ₹1 lakh or more.
2. ***The requisition must have been Deposited at the registered office of the company:*** (a) atleast 6 weeks before the meeting in case of a requisition requiring notice of a resolution; and (b) atleast 2 weeks before the meeting in case of any other requisition.
3. The statement to be circulated does not contain more than 1000 words.
4. The requisitionists must have deposited with the company a sum reasonably sufficient to meet the expense of the requisition.

Exceptions: Section 188 authorises a company not to circulate a resolution or statement of the requisition in the following cases: (a) The CLB, on the application of

the company or any other aggrieved party, is satisfied that the rights so conferred are being abused to secure needless publicity for defamatory matters. (b) The Board of Directors of a banking company considers that the circulation of the statement would injure the interests of the company.

Registration of Certain Resolution and Agreements **(Section 192):** A copy of the resolutions or agreements as enumerated in this section must within 30 days after their passing or making be forwarded to the Registrar of Companies who shall record the same.

8.6.4 Point of Order

A point of order deals with the conduct or procedure of the meeting. The chairman has to give his ruling or decision on a point of order at once. His ruling on any matter of procedure is final.

8.6.5 Minutes of Proceedings of Meeting

Minutes are a record of business transacted at meetings. Every organisation must keep minutes containing a fair and correct summary of all proceedings of general meetings of members and of Management Committee. It is the duty of the secretary to make this record.

After the meeting is over or as soon thereafter as possible, whilst the proceedings are still fresh in mind, the secretary should proceed to draft the minutes of the meeting. Each minute entered on the minute book should be consecutively numbered, abbreviated in the margin and indexed. They must be written in the order in which the business was transacted at the meeting. Minutes may be recorded either in the form of narration or conclusions. In the latter case, only conclusions in the form of resolutions passed are recorded. The practice is to have conclusions only. Details of the actual discussion and irrelevant talks should be omitted. The minutes should be clear, compact, unambiguous and definite. Minutes of each meeting must begin on a fresh page and should be headed with the number, date and nature of the meeting. The wording of resolutions and amendments must be recorded in full and the name of the proposer and seconder given, whether they are eventually carried or not.

Section 193 provides that every company must keep minutes containing a fair and correct summary of all proceedings of general meetings in books kept for that purpose. The minutes book must have their pages consecutively numbered and minutes must be recorded within 30 days of the meeting.

Check Your Progress

Fill in the blanks:

1. The Statutory Report is required to be certified as correct by atleast _____directors, one of whom shall be the managing director, where there is one.
2. Every company, whether public or private, having a share capital or not, limited or unlimited must hold this _____meeting.
3. _____ is convened for transacting some special or urgent business that may arise in between two AGMs, for instance, change in the objects or shift of registered office or alteration of capital.
4. A _____is the minimum number of persons whose presence is necessary for the transaction of business.
5. When persons present in a meeting indicate their approval or disapproval of the motion by clapping of hands, cheering or applause, it is known as voting by_____.

8.7 LET US SUM UP

- The different provisions of the Companies Act empower shareholders to exercise their rights therein at general meetings consequently, the act provides for calling and conducting meetings of members.
- There are four kinds of meetings which serve different purposes. These are: (i) statutory meeting; (ii) AGM; (iii) extraordinary general meeting and (iv) class meetings.
- A statutory meeting is required to be held once in the life of a company, which is a public company having a share capital. It must be held within a period of not less than one month and not more than six months from the date the company is entitled to commence business.
- The Board of Directors should get a report, called the statutory report, sent to each membering with the notice of the meeting.
- An annual general meeting (AGM) is to be held by every type of company. This meeting must be held in each calendar year and not more than fifteen months shall elapse between two such meetings.
- The business to be transacted at AGM may comprise of: (i) ordinary business and (ii) special business.
- If default is made in holding the AGM, then the Central Government may, on the application of any member of the company, call or direct the calling of the meeting. An extraordinary general meeting is convened for transacting some special or urgent business that may arise in between two annual general meetings.
- An extraordinary general meeting may be called by: (i) the directors of their own accord; (ii) the directors on requisition by the shareholders; (iii) the requisitionists themselves; (iv) by Company Law Board.

8.8 LESSON END ACTIVITY

A meeting was properly convened and was subsequently adjourned by the Chairman. No fresh notice was given for the adjourned meeting which has held subsequently. Discuss with your classmates whether the adjourned meeting is a valid meeting.

8.9 KEYWORDS

Agenda: The word 'agenda' indicates the business to be transacted at a meeting.

Proxy: Every member of a company entitled to attend and vote at a meeting has the right to appoint another person, whether a member or not, to attend and vote for him. The term 'proxy' is applied to the person so appointed.

Quorum: A quorum is the minimum number of persons whose presence is necessary for the transaction of business at a meeting.

Ordinary Resolution: When a motion is passed by simple majority of the members voting at a general meeting, it is said to have been passed by an ordinary resolution.

Special Resolution: A resolution is a special resolution when the number of votes cast in favour of the resolution is three times the number cast against it.

8.10 QUESTIONS FOR DISCUSSION

1. What are the different kinds of general meetings of a company?
2. Define statutory meeting of a public company.
3. Summarise the provisions as regards annual general meeting.
4. What are the provisions of the Companies Act, 1956 in respect of an extraordinary general meeting to be held on requisition?
5. Write a short note on the powers of the tribunal to call meetings.
6. Write short notes on: (i) Notice of a meeting (ii) Proxy (iii) Voting by poll (iv) Resolutions (v) Explanatory statement (vi) Quorum.

Check Your Progress: Model Answer

1. Two
2. Annual General
3. Extra-Ordinary General Meeting
4. Quorum
5. Acclamation

8.11 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition. 2006, Excel Books, New Delhi

S.S Gulshan, *Mercantile Law*, Third Edition, 2006, Excel Books, New Delhi

G. Vijayaragavan Iyengar, *Introduction to Banking*, 2007, Excel Books, New Delhi, India.

K.C. Garg, R.C., Chawla, Vijay Gupta, *Company Law*, Kalyani Publishers, Ludhiana

Company Law Journal, *Company Law Journal (India) Pvt. Ltd.*, New Delhi.

UNIT V

LESSON

9

MAJORITY POWERS AND MINORITY RIGHTS

CONTENTS

9.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Discuss the concept of shareholders' democracy
- Explain the powers of majority
- Elucidate the principle of non-interference or Rule in Foss v. Harbottle along with its justification and advantages
- Discuss the protection of minority rights and shareholders remedies
- Identify the prevention of oppression

9.1 INTRODUCTION

Democracy is always a better governance structure as compared to any other set up. It preserves the rights of every one either majority or minority. Most of the set ups are

always preserving the rights of the section to whom it is presenting. The oppression of minority is a normal thing everywhere either in economics or politics or in the companies.

The greed for money is that the companies are mismanaged for personal gains. This greed lies with the majority holders. The best set up for a company is that in which the minority rights are protected and also in which the mismanagement is avoided.

After reading this lesson you will be able to understand the concept of shareholders' democracy, the majority powers and minority rights.

The lesson describes the principle of non-interference in detail along with its justifications and advantages. It also deals with the provisions relating to protection of minority rights and shareholder's remedy. Provisions under the Companies Act for prevention of oppression and mismanagement have also been discussed herein. It may be noted that Chapter XVI of the Companies Act 2013 (Section 241-246) and the rules made there under, covering the aspects of oppression and mismanagement are yet to be notified and the provisions of Companies Act 1956 in this regard would continue to apply.

9.2 SHAREHOLDERS' DEMOCRACY

The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives. Democracy means the rule of people, by people and for people. In that context the shareholders democracy means the rule of shareholders, by the shareholders, and for the shareholders in the corporate enterprise, to which the shareholders belong. Precisely it is a right to speak, congregate, communicate with co-shareholders and to learn about what is going on in the company.

Under the Companies Act the powers have been divided between two segments: one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of board of directors and shareholders exercise their powers through General Meetings.

Although constitutionally all the acts relating to the company can be performed in General Meetings but most of the powers in regard thereto are delegated to the board of directors by virtue of the constitutional documents of the company viz. the Memorandum of Association and Articles of Association.

Under Section 291 of the Companies Act a general power has been conferred on the board of directors. The section provides that "Subject to the provisions of this Act, the board of directors of a company shall be entitled to exercise all such powers and to do all such acts and things, as the company is authorised to exercise and do".

Proviso to this section restricts the power of the board of directors to do things which are specifically required to be done by shareholders in the General Meetings under the provisions of Companies Act or Memorandum of Association or the Articles of Association.

Thus the Companies Act has tried to demarcate the area of control of directors as well as that of shareholders. Basically all the business to be transacted at the meetings of shareholders is by means of an ordinary resolution or a special resolution.

9.3 POWERS OF MAJORITY

As a company is an artificial person with no physical existence, it functions through the instrumentality of the board of directors who is guided by the wishes of the

majority, subject, of course, to the welfare of the company as a whole. It is, therefore, a cardinal rule of company law that prima facie a majority of members of a company are entitled to exercise the powers of the company and generally to control its affairs.

According to Section 87 of the Companies Act, 1956, every member of a company, which is limited by shares, holding any equity shares shall have a right to vote in respect of such capital on every resolution placed before the company. Member's right to vote is recognised as right of property and the shareholder may exercise it as he thinks fit according to his choice and interest. This rule is modified by the Act in certain cases.

A special resolution, for instance, requires a majority of 3/4th of those voting at the meeting and therefore, where the Act or the articles require a special resolution for any purpose, a three-fourth majority is necessary and a simple majority is not enough.

The resolution of a majority of shareholders, passed at a duly convened and held general meeting, upon any question with which the company is legally competent to deal, is binding upon the minority and consequently upon the company.

Thus, the majority of the members enjoy the supreme authority to exercise the powers of the company and generally to control its affairs. But this is subject to two very important limitations.

Firstly, the powers of the majority of members are subject to the provisions of the company's memorandum and articles of association. A company cannot legally authorise or ratify any act which being outside the ambit of the memorandum, is ultra vires of the company.

Also, where the articles authorise the directors to deal with any matters except those which are outside the scope of the authority of the directors; or with which the directors having power are unable or unwilling to deal.

Secondly, the resolution of a majority must not be inconsistent with the provisions of the Act or any other statute, or constitute a fraud on minority depriving it of its legitimate rights.

9.3.1 The Principle of Non-interference (Rule in Foss v. Harbottle)

The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members the issue is decided by a vote of the majority.

Since the majority of the members are in an advantageous position to run the company according to their command, the minorities of shareholders are often oppressed. The company law provides for adequate protection for the minority shareholders when their rights are trampled by the majority.

But the protection of the minority is not generally available when the majority does anything in the exercise of the powers for internal administration of a company.

The court will not usually intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company.

In other words, the articles are the protective shield for the majority of shareholders who compose the board of directors for carrying out their object at the cost of minority of shareholders. The basic principle of non-interference with the internal management of company by the court is laid down in a celebrated case of Foss v. Harbottle 67 E.R. 189; (1843) 2 Hare 461 that no action can be brought by a member against the

directors in respect of a wrong alleged to be committed to a company. The company itself is the proper party of such an action.

Caselet

In Foss v. Harbottle, two shareholders, Foss and Turton brought an action on behalf of themselves and all other shareholders against the directors and solicitor of the company alleging that by their concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board.

Foss and Turton claimed damages to be paid by the defendants to the company. It was held by the court that the action could not be brought by the minority shareholders although there was nothing to prevent the company itself, acting through the majority of its shareholders, bringing action.

The wrong done to the company was not which could be ratified by the majority of members. The company (i.e., the majority) is the proper plaintiff for wrong done to the company, so the majority of members are competent to decide whether to commence proceedings against the directors.

The reasons for rule were nicely stated by Melish L.J. in MacDougall v. Gardiner, (1875) 1 Ch. D. 13 (C.A.) at p. 25 in the following words: "If the thing complained of is a thing which in substance the majority of company are entitled to do, or if something has been done irregularly which the majority of the company are entitled to do regularly, or if something has been done illegally which the majority of the company are entitled to do legally, there can be no use in having litigation about it, the ultimate end of which is only that a meeting has to be called, and then ultimately the majority gets its wishes".

In Rajahmundry Electric Supply Co. v. Nageshwara Rao AIR 1956 SC 213, the Supreme Court observed that: "The courts will not, in general, intervene at the instance of shareholders in matters of internal administration, and will not interfere with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general do nothing about it".

From the above it follows then that a company being a separate legal person from the members who compose it, the company is the proper person to bring an action.

9.4 PROTECTION OF MINORITY RIGHTS AND SHAREHOLDERS REMEDIES

The rule in Foss v. Harbottle is not absolute but is subject to certain exceptions. In other words, the rule of supremacy of the majority is subject to certain exceptions and thus, minority shareholders are not left helpless, but they are protected by:

(a) The common law; and

(b) The provisions of the Companies Act, 1956.

9.4.1 Actions by Shareholders in Common Law

The cases in which the majority rule does not prevail are commonly known as exceptions to the rule in Foss v. Harbottle and are available to the minority. In all these cases an individual member may sue for declaration that the resolution

complained of is void, or for an injunction to restrain the company from passing it. The said rule will not apply in the following cases;

Ultra Vires Acts

Where the directors representing the majority of shareholders perform an illegal or ultra vires act for the company, an individual shareholder has the right to bring an action. The majority of shareholders have no right to confirm an illegal or ultra vires transaction of the company. In such case a shareholder has the right to restrain the company by an order or injunction of the court from carrying out an ultra vires act.

In Bharat Insurance Ltd. v. Kanhya Lal, A.I.R. 1935 Lah. 792, the plaintiff was a shareholder of the Bharat Insurance Company. One of the objects of the company was: "To advance money at interest on the security of land, houses, machinery and other property situated in India..."

The plaintiff complained that "several investments had been made by the company without adequate security and contrary to the provisions of the memorandum and therefore, prayed for perpetual injunction to restrain it from making such investments".

The Court observed: "In all matters of internal management, the company itself is the best judge of its affairs and the court should not interfere. But application of assets of a company is not a matter of internal management.

As directors are acting ultra vires in the application of the funds of the company, a single member can maintain a suit". It means that the rule in Foss v. Harbottle will operate in full force only when the majority of shareholders through their chosen directors act within the extent of the powers of the company.

Fraud on Minority

Where an act done by the majority amounts to a fraud on the minority; an action can be brought by an individual shareholder. This principle was laid down as an exception to the rule in Foss v. Harbottle in a number of cases.

In Menier v. Hooper's Telegraph Works, (1874) L.R. 9 Ch. App. 350, it was observed that it would be a shocking thing if the majority of shareholders are allowed to put something into their pockets at the expenses of the minority.

In this case, the majority of members of company 'A' were also members of company 'B', and at a meeting of company 'A' they passed a resolution to compromise an action against company 'B', in a manner alleged to be favourable to company 'B', but unfavourable to company 'A'. Held, the minority shareholders of company 'A' could bring an action to have the compromise set aside.

Though there is no clear definition of the expression "fraud on the minority", but the court decides a particular case according to the surrounding facts. The general test which is applied to decide whether a case falls in the category of fraud on the minority or not is whether a resolution passed by the majority is "bona fide for benefit of the company as a whole".

As regards to the meaning of the expression "bona fide for the benefit of the company as a whole" Evershed M.R. in Greenhalgh Ardeme Cinemas Ltd. (1950) 2 All E.R. 1120 has observed thus: "It means that the shareholder must proceed on what, in his honest opinion, is for the benefit, of the company as a whole"

Secondly, the phrase 'the company as a whole' does not... mean the company as a commercial entity as distinct from the corporators. It means the corporators as a general body.

In other words, it can be said that the court ought not to interfere with decision of the majority in a general meeting if that decision is arrived at fairly and honestly and is not an act of fraud on the minority.

Wrongdoers in Control

If the wrongdoers are in control of the company, the minority shareholders' representative action for fraud on the minority will be entertained by the court [Cf. Birch v. Sullivan, (1957) 1 W.L.R. 1274].

The reason for it is that if the minority shareholders are denied the right of action, their grievances in such case would never reach the court, for the wrongdoers themselves, being in control, will never allow the company to sue [Par Jenkins L.J. in Edwards v. Halliwell. (1950) 2 All E.R. 1064, 1067].

In Glass v. Atkin (1967) 65 D.L.R. (2d) 501, a company was controlled equally by the two defendants and the two plaintiff. The plaintiff brought an action against defendants alleging that they had fraudulently converted the assets of the company for their own private use.

The court allowed the action and observed: "While the general principle was for the company itself to bring an action, where it had an interest, since the two defendants controlled the company in the sense that they would prevent the company from taking action".

Resolution requiring Special Majority but is passed by a Simple Majority

A shareholder can sue if an act requires a special majority but is passed by a simple majority. Simple or rigid formalities are to be observed if the majority wants to give validity to an act which purports to impede the interest of minority.

An individual shareholder has the right of action to restrain the company from acting on a special resolution to which the insufficient notice is served [Baillie v. Oriental Telephone and Electric Co. Ltd., (1915) 1 Ch. 503 (C.A.); refer also Nagappa Chettiar v. Madras Race Club, 1 M.L.J. 662].

Personal Actions

Individual membership rights cannot be invaded by the majority of shareholders. He is entitled to all the rights and privileges appertaining to his status as a member.

An individual shareholder can insist on the strict compliance with the legal rules, statutory provisions. Provisions in the memorandum and the articles are mandatory in nature and cannot be waived by a bare majority of shareholders [Salmon v. Quin and Aztens, (1909) A.C. 442].

In Nagappa Chettiar v. Madras Race Club, (1949) 1 M.L.J. 662 at 667, it was observed by the Court that "An individual shareholder is entitled to enforce his individual rights against the company, such as, his right to vote, the right to have his vote recorded. or his right to stand as a director of a company at an election".

Where the candidature of a shareholder for directorship is rejected by the Chairman, it is an individual wrong in respect of which a suit is maintainable [Joseph v. Jos, (1964) 1 Comp LJ 105].

Breach of Duty

The minority shareholder may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.

In Daniels v. Daniels, (1978) 2 W.L.R. 73, the plaintiff, who were minority shareholders of a company, brought an action against the two directors of the company and the company itself.

In their statement of the claim they alleged that the company, on the instruction of the two directors who were majority shareholders, sold the company's land to one of the directors (who was the wife of the other) for £ 4,250 and the directors knew or ought to have known that the sale was at an under value.

Four years after the sale, she sold the same land for £ 1,20,000. The directors applied for the statement of claim to be disclosed on reasonable cause of action or otherwise as an abuse of the process of the Court. Held, by the Chancery Division, Templeman, J, the application of director should be dismissed.

The exception to the rule in Foss v. Harbottle enabling a minority of shareholders to bring an action against a company for fraud where no other remedy was available should include cases where, although there was no fraud alleged, there was a breach of duty by directors and majority shareholders to the detriment of the company and the benefit to the directors; accordingly, on the facts alleged, the minority shareholders had a cause of action.

Prevention of Oppression and Mismanagement

The minority shareholders are empowered to bring action with a view of preventing the majority from oppression and mismanagement. These are the statutory rights of the minority shareholders and find detailed discussion later in the study. It should be noted that the ordinary civil courts are not deprived of the jurisdiction to decide the matters except where the Companies Act expressly excludes it such as matters relating to winding up.

9.4.2 Statutory Remedies (under the Companies Act)

Though the shareholders' democracy is supreme the Companies Act and the decided cases suggest that the majority shall not be allowed to act in an unfair, fraudulent or oppressive way against the interests of the minority shareholders.

Under Section 38, 167, 388-B, 397, 398, and 399 various powers are given to the shareholders. Further, under Section 265 a company may adopt principle of proportional representation.

Under Section 408 the Central Government may direct the company to amend its articles providing for appointment of directors according to the principle of proportional representation under Section 265 and make fresh appointment in pursuance of the articles so amended within such time as may be specified.

The Companies Act, 1956, extends protection to minority by granting various rights to minority shareholders which are discussed as below:

(a) ***The variation of class rights:*** The rights attached to the shares of any class can be varied under Section 106 of the Act with the consent in writing of the holder of not less than three-fourths of the issued shares of that class or with the sanction of a special resolution passed at a separate meeting of the holders of the issued shares of that class. But the holders of not less than 10% of the shares of that class who had not assented to the variation may apply to the Court for the cancellation of the variation under Section 107 of the Act.

(b) ***Schemes of reconstruction and amalgamation:*** The minority is accorded with protection in cases where they dissent to the scheme of reconstruction or amalgamation.

(c) ***Oppression and mismanagement:*** The principle of majority rule does not apply to cases where Sections 397 and 398 are applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted, in a manner oppressive to some of the members including himself, or against public interest, he may apply to the Company Law Board by petition under Section 397 of the Act.

(d) ***Alternative remedy to winding up:*** Any member or members, who complain that the affairs of the company are being conducted in a manner oppressive to some of the members including themselves, may apply to the Company Law Board for redressal (Section 397).

(e) ***Investigation by the Government:*** Under Section 235 of the Act the Central Government may appoint one or more competent persons as inspectors to investigate the affairs of any company and to report thereon in such manner as the Central Government may direct:

(i) Where in case of a company, on a report by the Registrar, under Sub-section (6) or (7) of Section 234 read with Sub-section (6) of Section 234.

(ii) Where —

1. In the case of a company having a share capital on the application either of not less than 200 members or of member holding not less than one-tenth of the voting power thereof; and

2. In the case of a company not having a share capital, on the application of not less than one-fifth in number of persons on the company's register of members.

The Company Law Board, after giving the parties an opportunity of being heard, declare that the affairs of the company ought to be investigated by an inspector or inspectors.

9.5 PREVENTION OF OPPRESSION AND MISMANAGEMENT

As observed in the preceding topic that one of the exceptions to the majority rule laid down in Foss v. Harbottle is the right of the oppressed minority to get relief against the wrongful conduct of the majority.

This protection to the oppressed minority is also statutorily prescribed under section 397 of the Companies Act, 1956. This statutory protection for prevention of oppression and mismanagement is an alternative remedy for winding up of the affairs of the company. The reason is that the oppressed minority may file petition with the Company Law Board to wind up the company.

However, the company may be a sound and profitable concern. In that case, the petitioners will not only be deprived of whatever dividends they might have been getting but also the value of the assets of the company might be substantially reduced.

As Alfred Palmer rightly said: "The liquidation of the company may result in the sale of its assets at breakup value without regard to the value of the goodwill or 'know how' of the company and the minority shareholder who urged by the shareholder's oppression petitions for a winding up order may in effect play up his opponents game". The oppressed minority, therefore, are willing in such cases not to end the company but to mend it. Section 397 of the Companies Act, 1956, is intended to give a remedy alternative to compulsory winding up in such cases.

The first remedy in the hands of an oppressed minority is to move the Company Law Board. Section 397 provides that any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member (s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief. Following requirements must be satisfied for seeking a relief under Section 397: (i) That the affairs of the company are being conducted: (a) in a manner prejudicial to public interest; or (b) oppressive to any members. (ii) That the fact justified the compulsory winding up order on the ground that it is just and equitable that the company should be wound up. (iii) That to wind up the company would unfairly prejudice the petitioners [Ramji Lal Baiswala v. Britain Cable Ltd., (1964) 14 Raj. 135]. On being satisfied about the above requirements, the Company Law Board may make the necessary orders for ending the matters complained of. The first requirement relates to public interest or oppression. First we analyse and discover the precise connotation of the word "oppression" with the help of judicial decisions.

The words "oppression" and "mismanagement" are not defined in the Act. The meaning of these words for the purpose of Company Law should be used in a broad generic sense and not in any strict literal sense.

The meaning of the term "oppression" as explained by Lord Cooper in the Scottish case of Elder v. Elder & Western Ltd., (1952) Scottish Cases 49, which has been cited with approval by Wanchoo, J (afterwards C.J.) of the Supreme Court in Shanti Prasad v. Kalinga Tubes, (1965) 1 Comp. L.J. 193 at 204 is as under : "The essence of the matter seems to be that the conduct complained of should at the lowest, involve a visible departure from the standards of fair dealing, on which every shareholder who entrusts his money to the company is entitled to rely".

Caselet

An attempt to force new and more risky objects upon an unwilling minority may in circumstances amount to oppression. This was held in Re. Hindustan Co-operative Insurance Society Ltd., AIR. 1961 Cal. 443 wherein the life insurance business of a company was acquired in 1956 by the Life Insurance Corporation of India on payment of compensation. The directors, who had the majority voting power, refused to distribute this amount among shareholders, rather they passed a special resolution changing the objects of the company to utilise the compensation money for the new objects. This was held to be an "Oppression". The court observed: "The majority exercised their authority wrongfully, in a manner burdensome, harsh and wrongful. They attempted to force the minority shareholders to invest their money in different kind of business against their will. The minority had invested their money in a life insurance business with all its safeguards and statutory protections. But they were being forced to invest where there would be no such protections or safeguards".

9.5.1 Rule of Majority

The principle of rule by majority is made applicable to the management of affairs of the company. The shareholders pass resolutions on various subjects either by simple majority or by three-fourths majority. Once a resolution is passed, then it is binding on all the members of the company.

As a resultant corollary, the court will not intervene to protect minority against the resolution, as on becoming a member, the shareholder agrees to submit to the will of the majority of the members. Thus, if a wrong is done to the company, it is the company which is legal entity having its own personality, which can institute a suit

against the wrongdoer; and shareholders do not have a right to do so. This rule was laid down in the leading case of Foss v. Harbottle the facts of this case were as follows:

F and T brought an action on behalf of themselves and all other shareholders against the defendants who consisted of 5 directors, a solicitor and an architect of the company alleging that by concerted and illegal transactions they had caused the company's property to be lost to the company. It was also alleged that there was no qualified Board. F and T claimed damages from the defendants to be paid to the company.

The Court held, that the action could not be brought by the minority shareholders. The wrong done to the company was one which could be ratified by the majority of members. The company was the proper plaintiff for wrongs done to the company and the company can act only through its majority shareholders.

The majority of the members should be left to decide whether to commence proceedings against the directors. The principle of majority rule has since then been applied to a number of cases.

In Rajahmundry Electric Supply Co. v. Nageshwara Rao, AIR (1956) S. C. 213, the Supreme Court observed that· The Courts will not, in general, intervene at the instance of shareholders in matters of internal administration and will not interface with the management of the company by its directors so long as they are acting within the powers conferred on them under articles of the company. Moreover, if the directors are supported by the majority shareholders in what they do, the minority shareholders can, in general, do nothing about it.

One may notice that the aforesaid decisions are essentially a logical extension of the principle that a company is a separate legal person from the members who compose it.

Once it is admitted that a company is a separate legal person, it follows that 'if a wrong is done to it, the company is the proper person to bring an action'.

This is a simple rule of procedure which applies to all wrongs, viz., only the injured party may sue. If, for instance, X intentionally pushes Y down the stairs and Y breaks his leg in consequence, C, who has seen the whole incident cannot bring an action against X. C has not been hurt; he is not the injured party; he is the wrong plaintiff. The right plaintiff is Y.

The rule, as applied to companies, however, appears a little more complicated. After all, the directors who have been fraudulent have injured the company. The company is composed of members.

Losses to the company affect all the members, not simply the majority or the minority or any particular member. Why then, should an individual member not sue, since he has been injured?

The answer is that injury is not enough. The plaintiff must show that the injury has been caused by a breach of duty to him. In the course of existence a person suffers many injuries for which no action can be brought, for no duty owned to him has been broken.

The individual shareholders or even the minority shareholders who try to show that the directors owe a duty to them personally in their management of the company's assets will definitely fail. The directors own no duty to the individual members, but only to the company as a whole. A company is a person and if it suffers injury through breach of duty owed to it, then the only possible plaintiff is the company itself acting, as it must always act, through its majority.

It should, however, be noted that the aforesaid principle of Foss v. Harbottle applies only where a corporate right of a member is infringed. The rule doesn't apply where an individual right of a member is denied.

The shareholder, by his contract with company undertakes with respect to his rights which his membership carries to accept as binding upon him the decisions of the majority of shareholders, if arrived at in accordance with the law and the articles; these membership rights are referred to as corporate membership rights.

Other rights of the shareholder, such as right to vote, or right to receive dividend are his personal or individual rights and cannot be taken away by the majority and if the company refuses to record his vote or pay him the dividend, he can sue in his own name and this right of action is unaffected by any decision of the majority.

Exceptions to 'The Majority Rule' (Protection of Minority Rights). In the following cases the rule of Foss v. Harbottle does not apply, i.e., the minority the shareholders may bring an action to protect their interest:

1. ***Where the act done is illegal or ultra-vires the company.*** A shareholder is entitled to bring an action against the company and its officers in respect of matters which are illegal or ultra-vires the company since no majority of shareholders (not even the entire body of shareholders) can sanction such matters [Burland v. Earle (1902) A.C.83].

2. ***Breach of fiduciary duty.*** When a director is in breach of fiduciary duty, every shareholder may be regarded an authorised organ to bring the action [Santya Charan Lal v. Rameshwar Prasad Bajoria (1950) S.C.R. 394]. In Blakesly v. Johnson (1980), a U.S. case, the President Director of a corporation who was also the majority stockholder did not make adequate disclosure to the minority shareholder of facts concerning the sale of the business and as a result the latter allowed his stock to be redeemed by the corporation for an inadequate price. Held, the president was guilty of breach of fiduciary duty.

3. ***Where the act complained of constitutes a fraud on the minority.*** Where the majority of a company's members use their power to defraud or oppress the minority, their conduct is liable to be impeached even by a single shareholder. Justice Evershed, M.R. in Greenhalgh v. Ardene Cinemas Ltd. (1951) said, "a special resolution would be liable to be impeached if the effect of it were to discriminate between the majority shareholders and minority shareholders, so as to give the former an advantage of which the latter were deprived".

   Thus, where the majority of members of company 'A', who were also members of company 'B', passed a resolution to compromise an action against company 'B'. The resolution was charged to be favourable to company 'B' but unfavourable to company 'A'. *Held*, the minority of company 'A' could get the compromise set aside (Menier v. Hooper's Telegraph Works Ltd.).

4. Where an Act which requires special resolution to be effective but has, in fact, been done by a simple majority.

5. ***Where the personal rights of an individual member have been infringed.*** As already noted, the principle of majority rule is applicable only to the corporate membership rights of a member. Infringement of a member's individual rights like right to vote, right to receive dividends, etc., entitles him to proceed in his own name.

6. ***Protection under the Companies Act.*** The Companies Act, 1956, vide certain specific provisions, extends protection to the minority shareholders by conferring certain rights on them:

(i) ***Variation of class rights.*** Where the share capital of a company is divided into different classes of shares, the rights attached to the shares of any class can be varied as provided in the memorandum or articles of the company with the consent of the 3/4th majority of the shareholders of that class. Where this is done and the rights are varied by the requisite majority vote, the holders of not less than 10 percent of the issued shares of that class who had not assented to the variation may apply to the Court for the cancellation of the variation under Section 107.

(ii) ***Scheme of reconstruction and amalgamation.*** Section 394 provides for schemes of reconstruction and gives protection to minorities. No compromise or arrangement in connection with a scheme for the amalgamation of the company shall be sanctioned by the court unless it has received a report from the Registrar that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest.

(iii) ***Oppression and mismanagement.*** The principle of majority rule does not apply to cases where Sections 397 and 398 are applicable for prevention of oppression and mismanagement. A member, who complains that the affairs of the company are being conducted in the manner oppressive to some of the members including himself, may apply to the Court by petition under Section 397. In O.P. Gupta v Shiv General Finance (P) Ltd. (1977), the Delhi High Court held, that a member's right to move the Court under Section 397 was a statutory right and cannot be affected by an arbitration clause in the Articles of Association of a company.

(iv) ***Rights of dissentient shareholders at the time of takeover bids.*** When an offer for the purchase of all the shares is received and the offer is accepted by the holders of 90 percent of the shares, the party making the offer may, on the same terms acquire the remaining shares also. But a notice is to be given to the dissenting shareholders who have a right to apply to the court praying that their shares should not be allowed to be acquired, on the terms of the scheme. On hearing the parties concerned, the court makes an order as it may think fit.

9.5.2 Powers of Company Law Board for Prevention of Mismanagement and Oppression (Sections 397-399 and 402)

Section 397 provides that any member of a company who complains that its affairs are being conducted in a manner oppressive to any member or members (including any one or more of themselves) may apply to the Company Law Board under this section. With a view to bring an end the matters complained of, the Company Law Board may make such order as it thinks fit under this section, if it is of opinion that– (i) the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members; and (ii) to wind up the company would unfairly prejudice the members who have lodged the complaint, but the court would be prepared to make a winding up order on the ground that it is just and equitable that the company should be wound up.

An application may also be made under Section 398 to the Company Law Board by any members of a company who complain that – (i) the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner prejudicial to the interest of the company; or (ii) a material change has taken place in the management or control of the company and that by reason of such change, it is likely that the affairs of the company will be conducted in a manner prejudicial to public interest or in a manner prejudicial to the interests of the company.

After hearing the petition, the Company Law Board may pass such order as it thinks fit.

Persons Entitled to Complain. Section 399 specifies the persons who are entitled to apply to the Company Law Board, for relief in cases of oppression and mismanagement complained of in pursuance of Sections 397-398. The numbers necessary to make such application is: (i) in the case of a company having a share capital, 100 members or 10 percent of the total number of its members whichever is less, or members holding 10 percent of the issued share capital; (ii) in the case of a company not having a share capital, 20 percent (one-fifth) of the total number of its members. The Central Government is empowered in an appropriate case to authorise any lesser number of members to make such application to the Company Law Board.

Section 402 provides for the relief that can be provided by the Company Law Board and the CLB's order may include: (a) the regulation of the conduct of the company's affairs in future; (b) the acquisition of the shares or interests of any members by other members or by the company; (c) the consequent reduction of the share capital in case of (b) above; (d) termination, setting aside or modification of any agreement, however arrived at, between the company and the manager, managing director or any other director; (e) termination, setting aside or modification of any agreement between the company and any other person with the latter's consent; (f) setting aside of any transfer, delivery of goods, payment, execution or other act relating to the property made or done by or against the company within three months of the application which would amount to fraudulent preference in case of an individual's insolvency; (g) any other matter for which, in the opinion of the Company Law Board, it is just and equitable that provision should be made.

9.5.3 Powers of Central Government to Prevent Oppression or Mismanagement

Section 408 empowers the Central Government to prevent oppression or mismanagement by nominating directors on the Board of directors of a company.

9.5.4 Investigation

Besides the aforesaid provisions, to prevent oppression or mismanagement by those who control the affairs of the company, the Act contains certain provisions under the head Investigation.

Check Your Progress

Fill in the blanks.

1. The articles are the protective shield for the majority of shareholders who compose the board of directors for carrying out their object at the cost of _____ of shareholders.
2. Where the directors representing the majority of shareholders perform an _____ for the company, an individual shareholder has right to bring an action.
3. _____ refers to an improper exercise of voting power by the majority of members of a company.
4. The _____ may bring an action against the company, where although there is no fraud, there is a breach of duty by directors and majority shareholders to the detriment of the company.
5. The principle of _____ is made applicable to the management of affairs of the company. The shareholders pass resolutions on various subjects either by simple majority or by _____ majority.

9.6 LET US SUM UP

- The concept of shareholders' democracy in the present day corporate world denotes the shareholders' supremacy in the governance of the business and affairs of corporate sector either directly or through their elected representatives.
- Under the Companies Act the powers have been divided between two segments; one is the Board of Directors and the other is of shareholders. The directors exercise their powers through meetings of board of directors and shareholders exercise their power through Annual General Meetings/Extra-ordinary General Meetings.
- The general principle of company law is that every member holds equal rights with other members of the company in the same class. The scale of rights of members of the same class must be held evenly for smooth functioning of the company. In case of difference(s) amongst the members, the issue is decided by a vote of the majority.
- Since the majority of the members are in an advantageous position to run the company according to their command, the minority shareholders are often oppressed. The company law provide for adequate protection for the minority shareholders when their rights are trampled by the majority.
- The court will not usually intervene at the instance of shareholders in matters of internal administration and will not interfere with the management of a company by its directors so long they are acting within the powers conferred on them under the articles of the company.
- The supremacy of the majority, however, does not prevail in all situations. There are certain acts which the majority of shareholders cannot approve or affirm. In such cases, any shareholder may sue to enforce obligations owed to the company. He brings the action as representative of the corporate interest.
- Any member of a company who complain that the affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member(s) (including any one or more of themselves) may make an application to the Company Law Board by way of petition for relief.

9.7 LESSON END ACTIVITY

The articles of a company provided for the taking of a poll at a general meeting of the company if so demanded by five shareholders. At a general meeting the Chairman, in breach of the articles, declined to take a poll. One of the shareholders brought an action on behalf of himself and other shareholders against the directors and company, seeking a declaration that decisions taken at the meeting were invalid and seeking an injunction to restrain their implementation. Are the shareholders competent to file the suit?

9.8 KEYWORDS

Democracy: Democracy means the rule of people, by people and for people.

Oppression: As per Section 397(1) of Companies Act 1956 has been defined as 'when affairs of the company are being conducted in a manner prejudicial to public interest or in a manner oppressive to any member or members'.

Reconstruction: When a company is suffering loss for several past years and suffering from financial difficulties, it may go for reconstruction.

Amalgamation: Amalgamation is defined as the combination of one or more companies into a new entity.

9.9 QUESTIONS FOR DISCUSSION

1. "A company is a democratic institution in which the majority have a right to control the company". Do you support this statement? Give your comments in the rule laid down in Foss v. Harbottle.
2. Explain clearly the meaning of 'majority rule' as applied in managing a company registered under the Companies Act 1956. Are there any exceptions to this rule? If so, explain in the light of the statutory law and case law.
3. "The rule in Foss v. Harbottle presently has lost its importance because of adequate statutory provisions made in the Companies Act, 1956". Discuss the adequacy of these provisions.
4. "Majority will have its way but minority must be allowed to have its say". Discuss the above proposition with reference to prevention of oppression and mismanagement?
5. Enumerate the powers of the Company Law Board to prevent oppression and mismanagement. What are the powers of the Central Government to prevent oppression and mismanagement?

Check Your Progress: Model Answer

1. Minority
2. Illegal or ultra vires act
3. Fraud on the minority
4. Minority shareholder
5. Rule by majority, three-fourths

9.10 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi

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LESSON

10

WINDING UP OF COMPANIES

CONTENTS

10.0 AIMS AND OBJECTIVES

After studying this lesson, you should be able to:

- Identify the types and methods of winding up
- Discuss the liquidators
- Explain the dissolution of companies

10.1 INTRODUCTION

Winding up of a company is the process whereby its life is ended and its property administered for the benefit of its creditors and members. An administrator called a 'liquidator', is appointed and he takes control of the company, collects its assets, pays its debts and finally distributes any surplus among the members in accordance with

their rights. In simple words winding up means applying the assets of a company in the discharge of its liabilities and returning any surplus to those entitled to it, subject to the cost of doing so. The statutory process by which this is achieved is called 'liquidation'. Winding up of a company differs from insolvency of an individual inasmuch as a company cannot be made insolvent under the insolvency law. Besides, even a solvent company may be wound up.

10.2 TYPES AND METHODS OF WINDING UP

A company may be wound up in any of the three ways: A. Compulsory winding up under an order of the Court. B. Voluntary winding up. C. A voluntary winding up under the supervision of the Court.

10.2.1 Winding Up by the Court

Winding up by the court, also called compulsory winding up, may be ordered in cases mentioned in Section 433. The Court will make an order for winding up on an application by any of the persons enlisted in Section 439.

Grounds for compulsory winding up [Section 433(3)]. A company may be wound up by the Court on the following grounds:

Special resolution. The company may by special resolution, resolve that it be wound up by the court. The resolution may be passed for any cause whatsoever. However, the court may not order winding up if it finds it to be opposed to public interest or the interest of the company as a whole.

Default in holding statutory meeting. If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting, the company may be ordered to be wound up. Petition on this ground can be presented either by the Registrar or by a contributory. If it has to be filed by any other person it should be filed before the expiration of 14 days after the last day on which the statutory meeting ought to have been held [Section 439 (7)].

Failure to commence business. If a company does not commence business within a year from incorporation or suspends business for a whole year, it may be ordered to be wound up. Failure to commence or to carry on business is not treated as a ground for compulsory winding up unless the company has no intention of carrying on business or it has become impossible to do so.

Reduction in membership. If the number of members is reduced below the statutory minimum of 7 in a public company or 2 in a private company, the company may be ordered to be wound up.

Inability to pay debts. The court may order a company to be wound up if it is unable to pay its debts. According to Section 434, a company shall be deemed to be unable to pay its debts if: (a) a creditor for more than one lakh rupees has served on the company at its registered office a demand under his hand requiring payment and the company has for three weeks thereafter neglected to pay or secure or compound the sum to the reasonable satisfaction of the creditor; or (b) execution or other process issued on a judgement or order of any court in favour of a creditor of the company is returned unsatisfied in whole or in part; or (c) it is proved to the satisfaction of the court that the company is unable to pay its debts, taking into account its contingent and prospective liabilities.

The provision that the court is to take into account the company's contingent and prospective liabilities is important. A company which has to date paid all its debts as they fell due may still be ordered to be wound up if a consideration of its assets and liabilities shows that it will or may shortly be unable to do so. Inability is to be seen in

the commercial sense of a running enterprise and not in the sense of liquidation, i.e., if the company cannot meet its current demand, even though its assets, when realised, would exceed its liabilities, it will be deemed to be unable to pay its debt and may be wound up.

But the important condition to be fulfilled is that the creditor should have a complete title to the debt and the debt must have become payable. Where there is a *bona fide* dispute regarding the debt, the company cannot be charged to have neglected to pay it.

Just and equitable. The court may also order for the winding up of a company if it is of the opinion that it is just and equitable that the company should be wound up. In exercising its power on this ground, the court shall give due weight to the interest of the company, its employees, creditors and shareholders and the interest of the general public. The relief based on the just and equitable clause is in the nature of a last resort when other remedies are not efficacious enough to protect the general interests of the company. While in the above five cases definite conditions should be fulfilled but in the 'just and equitable' clause the entire matter is left to the 'wide and wise' direction of the CLB. The winding up must be just and equitable not only to the persons applying but also to the company and to all its shareholders [*Hind Overseas Pvt. Ltd. v. R.P. Jhunjhunwala (1977) ASIL, XIII*]. A few of the examples of 'just and equitable' grounds on the basis of which the CLB may order the winding up are given below:

(i) When the substratum of the company has gone. The substratum of a company is deemed to be gone where its objects have failed or become impossible of achievement.

(ii) When there is a complete deadlock in the management. A company will be wound up on this ground even though it is making good profits. In Re-Yenidje Tobacco Co. Ltd. A and B, the only shareholders and directors of a Private Limited company became so hostile to each other that neither of them would speak to the other except through the secretary. Held, there was a complete deadlock and consequently the company was wound up.

(iii) Where the company was formed for fraudulent or illegal purposes. For this purpose, fraud in the prospectus or in the manner of conducting company's business is not sufficient. It must be shown that the original object of creating the company was fraudulent or illegal [*Re T. E. Brismead & Sons Ltd. (1897)1 Ch.45*].

(iv) Where the principal shareholders have adopted an aggressive or oppressive policy towards the minority [R. Sabapathy Rao v. Sabapathy Press Ltd. AIR (1925) Mad. 489]. However, the CLB will order winding up only when it is satisfied that it is impossible for the business of the company to be carried on for the benefit of the company as a whole because of the way in which voting power is held and used.

(v) When the company is a 'bubble', i.e., it never had any real business [Re-London and Country Coal C. (1867) L.R. 3 Eq. 365].

(vi) Where the business of the company cannot be carried except at loss. But, mere apprehension on the part of some shareholders that loss instead of gain will result has been held to be no ground [Re-Mahamandal Shastra Prakashik Samiti Ltd. (1917) 15 All L.T. 193]. Similarly, in Re-Shah Steamship Navigation Co. [(1901) 10 Bom. L.R. 107], it was that 'The Court (now CLB) will not be justified in making winding up order merely on the ground that the company has made losses and it was likely to make further losses'.

(vii) Where a private company is in essence or substance a partnership, it may be ordered to be wound up if such circumstances exist under which it would be just and equitable for the court to order for the dissolution of the partnership firm. In Re-Davis and Coltett Ltd. [(1935) Ch. 693] one member improperly excluded the other, who held half the shares, from taking part in the company's business. Held, the company be wound up.

(viii)Requirements for Investigation Where directors were making allegations of dishonesty against each other in respect of defalcations of the funds of the company, the company was ordered to be wound up on the ground that it was a case in which the conduct of some of the officers of the company required an investigation which could only be obtained in a winding up by the Court [Re Varieties Ltd. (1893) 2 Ch. 235].

Who may petition (Section 439). A petition for the compulsory winding up of a company may be presented by: (1) the company itself by the passing of a special resolution; or (2) any creditor or creditors, including any contingent or prospective creditor or creditors; or (3) a contributory or contributories; or (4) any combination of creditors, company or contributories acting jointly or separately; or (5) the Registrar; or (6) any person authorised by the Central Government, as per Section 243. (7) the official liquidator (Section 440).

The company [Section 439(1) (a)]. A company may make a petition for its winding up, when the members of the company have so resolved by passing a special resolution. However, it is not very common for companies to apply for winding up orders since, if desired, they have only to pass a special resolution for voluntary winding up under Section 484 of the Act. But, where the directors find the company to be insolvent due to circumstances which ought to be investigated by the CLB, they may file a petition for winding up order on behalf of the company.

Creditor's petition [Section 439(1) (b)]. A creditor has a right to a winding up. If he can prove that he claims an undisputed debt and that the company has failed to discharge it. The word 'Creditor' includes secured creditor, debenture holder and a trustee for debenture holders. It is not even necessary that the secured creditor should give up his security [In Re-India Electric Works (1969) 2 Comp. L.T. 169]. A contingent or prospective creditor (such as the holder of a bill of exchange not yet matured or of debentures not yet payable) is also entitled to petition for winding up the company. But, he must give a reasonable security for costs and establish a prima facie case for winding up [Section 439 (8)].

Sometimes a creditor's petition is opposed by other creditors. In such cases the CLB may ascertain the wishes of the majority of the creditors. However, the opinion of the majority of creditors does not bind the court. The question will ultimately depend upon the state of the company. If the company is commercially insolvent and the object of trading at a profit cannot be attained, winding up order will follow as a matter of course.

A creditors' petition is generally based on the ground that the company is unable to pay its debts. He will not ordinarily be heard to urge that a winding up order should be made because the substratum of the company is gone which is usually the proper concern of the company's shareholders [Bukhtiarpur Bihar Light Rly. Co. Ltd. v. Union of India, AIR (1954) Cal.499]. However, if the debt of a petitioning creditor is disputed no order for winding up can be made [Md. Amin Bros v. Dominition of India, AIR (1952) Cal. 323].

Contributory's petition [Section 439(1) (c)]. A 'contributory' means any person liable to contribute to the assets of a company in the event of its being wound up. But for this purpose the term 'contributory' includes a holder of fully paid shares. A

'contributory', however, may petition only: (i) on the ground that the number of members is reduced below the statutory minimum of seven members in case of public company and two in case of a private company; (ii) on any other ground if the shares in respect of which he is a contributory or some of them were originally allotted to him, or/have been held by him and registered in his name for atleast six out of the eighteen months preceding the commencement of the winding up, or/have devolved upon him through the death of the former holder.

Example: A transfer though executed and stamped in June, 1997, was registered in October, 1998. The shareholder presented a winding up petition in December, 1998. ***Held:*** the petition was not valid since she had not held shares for six months as required by the Act.

A holder of fully paid shares is a contributory for the purpose of a petition not because he is liable to contribute but because he may have an interest in the assets in a winding up. The section provides: "A contributory shall be entitled to present a petition for winding up a company notwithstanding that he may be the holder of fully paid-up shares, or that the company may have no assets at all or may have no surplus assets left for distribution among the shareholders after the satisfaction of its liabilities".

The legal representative of a deceased shareholder may petition. Even an insolvent shareholder, whose name is still there on the register, may, at the instance of the assignee, petition.

Joint Petition [Section 439(1) (d)]. By all or any of the parties specified above. This means that any combination of the company, the creditors and the contributories can present a petition for winding up.

The Registrar [Section 439(1)(e)]. The registrar may file a petition where: (i) a default is made in delivering the statutory report to him or in holding the statutory meeting; or (ii) the company has not commenced its business within a year from its incorporation; or (iii) the number of its members has fallen below the statutory minimum; or (iv) the financial condition of the company, as disclosed in its balance-sheet or from the report of a special auditor appointed under Section 233A or any inspector appointed under Sections 235 to 237 it appears that it is unable to pay its debts; or (v) it is just and equitable that the company be wound up.

The petition on the ground of default in delivering the statutory report or holding the statutory meeting cannot be presented before the expiration of 14 days after the last day on which the statutory meeting ought to have been held. In any case, the registrar cannot present the petition unless sanctioned by the Central Government.

Central Government Petition (Section 243). The Central Government may petition for winding up where it appears from the report of inspectors appointed to investigate the affairs of a company under Section 235 that the business of the company has been conducted for fraudulent or unlawful purposes. The Government may authorise any person to act on its behalf for the purpose [Section 439(1)(b)].

Official Liquidator's Petition (Section 440). An official liquidator may present a petition for winding up by the Court where a company is being wound up voluntarily. The Court, however, shall not make a winding up order unless it is satisfied that the voluntary winding up cannot be continued with due regard to the interest of the creditors or contributories or both.

Commencement of Winding Up (Section 441). The winding up of a company by the court shall be deemed to commence at the time of the presentation of the petition for the winding up. If no order for winding up is made and the winding up petition is dismissed, the date of presentation of the winding up petition has no relevance. As such, until winding up order is made, the company will have to comply with the

requirements of the Companies Act as are required if company not wound up. Also the words 'shall be deemed to commence' indicate that although the winding up of a company does not in fact commence at the time of the presentation of the petition, it nevertheless shall be taken to commence from that time if and when the winding up order is made However, where before the presentation of a petition for the winding up of a company by the Court, a resolution has been passed by the company for voluntary winding up, the winding up of the company is deemed to have commenced at the time of the passing of the resolution.

Procedure for winding up order

The winding up petition must be presented to the Court.

After the presentation of the petition but before the hearing, application may be made to the Court either by the company, creditor or contributories: to appoint a provisional liquidator to safeguard the assets pending the hearing. Before making such appointment, however, the Court must give notice to the company so as to enable it to make its representation in the matter unless, for reasons to be recorded in writing, it thinks fit to dispense with such notice. The powers of the provisional liquidator are the same as those of a liquidator unless limited by the Court (Section 450).

On hearing a winding up petition, the Court may [Section 443(1)]: (i) dismiss it, with or without costs; or (ii) adjourn the hearing conditionally or unconditionally; or (iii) make any interim order that it thinks fit; or (iv) make an order for winding up the company with or without costs, or any other order that it thinks fit.

The Court cannot, however, refuse to make a winding up order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets or that the company has no assets. "Where the petition is presented on the ground that it is just and equitable that the company should be wound up, the Court may refuse to make an order of winding up if it is of the opinion that some other remedy is available to the petitioners and that they are acting unreasonably in seeking to have the company wound up instead of pursuing that other remedy" [Section 443 (2)].

Where the petition is presented on the grounds of default in delivering the statutory report to the registrar or in holding the statutory meeting, the Court may: (a) instead of making a winding up order, direct that the statutory report shall be delivered or that a meeting shall be held; and (b) order the costs to be paid by persons who, in the opinion of the court, are responsible for the default [Section 443 (3)].

In all matters relating to the winding up of a company, the Court may have regard to the wishes of creditors or contributories of the company as proved to it by any sufficient evidence and for the purpose may direct that their meetings may be held or conducted as directed by the court (Section 557).

Consequence of winding up order. The consequence of winding up order through court are as follows:

1. The Court must, as soon as the winding up order is made cause intimation thereof to be sent to the official liquidator and the Registrar (Section 444).
2. The petitioner and the company must also file with the Registrar within 30 days a certified copy of the order [Section 445(1)]. The Registrar should file with himself a certified copy of the winding up order of the Court when himself is a petitioner under Section 439. If default is made in filing the certified copy of the order, the petitioner, or the company and every officer of the company who is in default, shall be punishable with fine upto ₹1,000 for everyday during which the default continues (Section 445).

3. The Registrar should then make a minute of the order in his books relating to the company and notify in the Official Gazette that such an order has been made [Section 445(2)].

4. The order for winding up is deemed to be a notice of discharge to the officers and employees of the company, except when the business of the company is continued [Section 445(3)].

5. The order operates in the interests of all the creditors and all the contributories, no matter who in fact asked for it (Section 447).

6. The Official Liquidator, by virtue of his office becomes the liquidator of the company and takes possession and control of the assets of the company (Section 449).

7. All actions and suits against the company are stayed, unless the Court gives leave to continue or commence proceedings (Section 446).

8. All the power of the Board of Directors cease and the same are then exercised by the liquidator [Sections 491 & 505].

9. On the commencement of winding up, the limitation ceases to run in favour of the company.

10. Any disposition of the property of the company and any transfer of shares in the company or alteration in the status of members made after the commencement of winding up shall, unless the Court otherwise orders, be void [Section 536(2)].

11. Any attachment, distress or execution put in force, without leave of the Court, against the estate or effects of the company after the commencement of the winding up shall be void [Section 537 (a)] but not for dues payable to Government [Section 537(2)].

12. Any sale held, without leave of the Court, of any of the properties or effects of the company after the commencement of winding up shall be void [Section 537(b)].13. Any floating charge created within 12 months preceding the commencement of winding up is void unless it is proved that the company after the creation of the charge was solvent, except as to, any cash advanced at the time of or subsequent to the creation of the charge or to any interest on that amount @ 5% or such other rate notified by the Central Government (Section 534).

The secured creditor is outside the winding up and can realise his security without the leave of the Court.

Statement of affairs to be made to the liquidator (Section 454). When a winding up order is made by the Court, the directors of the company must make to the liquidator a statement as to the affairs of the company, stating the following particulars: (i) the debts and liabilities of the company; (ii) the assets of the company, showing separately the cash in hand and in bank, if any; (iii) the name, residence and occupation of each creditor stating separately the amount of secured debts and unsecured debts; (iv) the debts due to the company and the name, residence and occupation of each person from whom the sum is due and the amount likely to be realised therefrom.

The object of such a statement is to give the liquidator an idea as to the financial affairs and liabilities of the company. The creditors and contributories of the company can inspect the statement. The statement should be made within 21 days (or such extended time not exceeding 3 months as the official liquidator or Court may for special reasons allow) after the relevant date.

The relevant date is the date of the winding up order by the CLB or where a provisional liquidator is appointed, the date of his appointment. The statement must be

submitted and verified by affidavit by one or more of the persons who, at the relevant date are the Directors and by the person who at that time is the Manager, Secretary or other Chief Officer of the company.

Defaulter shall be punishable with imprisonment upto 2 years or with fine upto ₹1,000 for everyday during which default continues or with both.

Committee of inspection. The Court may, at the time of making an order of winding of a company or at any time thereafter, direct that there shall be appointed a committee of inspection to act with the liquidator. In such a case the liquidator must, within 2 months from the date of such direction convene a meeting of the creditors of the company for the purpose of determining who are to be members of the committee.

Within 14 days from the date of the creditors meeting (or such further time as the court in its direction may grant for the purpose), the liquidator should convene a meeting of the contributories to consider the decision of the creditors' meeting with respect to the membership of the committee. It is open to the meeting of the contributories to accept the decision of the creditors' meeting with or without modifications or to reject it.

The liquidator must apply to the Court for directions as to what the composition of the committee shall be and who shall be members thereof. However, it will not be necessary to seek directions in this regard where the meeting of the contributories accepts the decision of the creditors' meeting in its entirety.

Section 465 provides: (i) a committee of inspection cannot have more than 12 members; (ii) the committee shall have the right to inspect the accounts of the liquidator at all reasonable times; (iii) it must meet at such times as it may from time to time appoint and the liquidator or any member of the committee may also call a meeting of the committee as and when he thinks necessary; (iv) the quorum for the meeting of the committee shall be 1/3rd of the total number or two whichever is higher; (v) a member of the committee may resign by notice in writing. But where a member of the committee is adjudged an insolvent or compounds or arranges with his creditors, or is absent from five consecutive meetings of the committee without the leave of the members, he shall cease to remain a member.

General powers of the Court

1. ***Power of Court to stay winding up (Section 446).*** The Court may at any time after making a winding up order (on the application either of the Official Liquidator of any creditor or contributor and on proof to the satisfaction of the CLB that all proceedings in relation to the winding up order be stayed) make an order staying the proceedings either altogether or for a limited time, on such terms and conditions as the CLB thinks fit.

2. ***Settlement of the list of contributories (Section 467).*** The Court has the power to cause the assets of the company to be collected and applied in discharge of its liabilities. For this purpose the court has the power to make a list of contributories. In settling the list of contributories the CLB shall distinguish between those who are contributories in their own right and those who are contributories as being representatives of, or liable for the debts of others.

3. ***The power to make calls (Section 470).*** The Court is empowered to make call on all or any of the contributories to the extent of their liability. It should be noted that no statutory liability for an unpaid call can be set off against a credit except in the following cases: (a) in the case of an unlimited company, a contributory may set off his debt against any money due to him from the company on any independent dealing or contract with the company. But no set off is allowed for any money due to him as a member of the company in respect of any dividend or

profit; (b) if, in the case of a limited company, there is any director or manager whose liability is unlimited, he shall have the same right of set off as described in (a) above; (c) in the case of any company, whether limited or unlimited when all the creditors have been paid in full, any money due on any account whether to a contributory from the company may be allowed to him by way of set off against any subsequent call.

4. ***Payment into bank of moneys due to company (Section 471).*** The Court may order any contributory, purchaser or other person from who any money is due to the company to pay the money into the public account of India in the Reserve Bank of India instead of to the liquidator.

5. ***Power to exclude creditors not proving in time (Section 474).*** The Court may fix a time or times within which creditors are to prove their debts or claims. In such a case, if the creditors fail to establish their claims in time, they may be excluded from the benefit of any distribution made.

6. ***Adjustment of rights of contributories (Section 475).*** The Court is empowered to adjust the right of the contributories among themselves and distribute any surplus among the person entitled thereto.

7. ***Power to order costs (Section 476).*** The Court may, in the event of assets being insufficient to satisfy the liabilities, make an order for the payment out of the asset, of the costs, charges and expenses incurred in the winding up, in such order of priority inter se as the court thinks just.

8. ***Power to summon persons suspected of having property of company, etc. (Section 477).*** The Court may summon before it any officer of the company or person known or suspected to have in his possession any property or books or papers of the company or known or suspected to be indebted to the company. Any such person may be examined on oath. The Court may also require him to produce any books and papers in his custody or power relating to the company; but where he claims any lien on books or papers produced by him, the production must be without prejudice to that lien.

   If any officer or person summoned, after being paid or tendered a reasonable sum for his expenses, fails to appear before the Court at the time appointed without any valid reason, the court may cause him to be apprehended and brought before the Court for examination.

9. ***Power to order public examination of promoter, directors, etc. (Section 478).*** Where the Official Liquidator has made a report to the Court, stating that in his opinion a fraud has been committed by any person in the promotion or formation of the company, or by any officer of the company since its formation, the CLB may direct that person or officer may appear before the Court and be publicly examined. Examination shall relate to the promotion or formation or the conduct of the business of the company, or as to his conduct and dealings as an officer thereof. Official Liquidator, any creditor or contributory may take part in such examination.

   The Court may put such questions to the person examined as it thinks fit. The person shall be examined on oath and must answer all such questions as the CLB may put or allow to be put, to him. Notes of the examination must be taken in writing and must be read over to or by and signed by the person examined and may thereafter be used in evidence against him. Statement so recorded shall be open to the inspection of any creditor or contributory at all reasonable times.

10. ***To order the appointment of a committee of inspection.*** (Already discussed)

11. ***Power to arrest a contributory intending to abscond (Second 479).*** At any time (either before or after making a winding up order), the Court may, on proof of probable cause for believing that a contributory is about to quit India or otherwise to abscond or is about to remove or cancel any of his property, for the purpose of evading payment of calls or of avoiding examination in respect of the affairs of the company, cause: (a) the contributory to be arrested and safely kept until such time as the Court may order; and (b) his books and papers and movable property be seized and safely kept until such time as the court may order.

12. ***Power to order for dissolution of the company (Section 481).*** When the affairs of a company have been completely wound up or when the Court is of the opinion that the liquidator cannot proceed with the winding up of a company for want of funds and assets or for any other reason whatsoever and it is just and reasonable in the circumstances of the case that an order of dissolution of the company should be made, the Court shall make an order that the company be dissolved from the date of the order. The liquidator must, within 30 days, send a copy of the order to the Registrar who shall make in his books a minute of the dissolution of the company. If he makes a default in forwarding a copy as aforesaid, he shall be punishable with fine which may extend to ₹500 for everyday during which the default continues.

    On the expiry of 5 years from the date of dissolution, the name of the company should be struck off the Register. But within 2 years of the date of the dissolution on application by the liquidator of the company or by any other person who appears to the Court to be interested, the Court may make an order, upon such terms as the Court thinks fit, declaring the dissolution to have been void. After such an order is passed, such proceedings may be taken as might have been taken if the company had not been dissolved (Section 559)

10.2.2 Voluntary Winding Up

Winding up by the creditors or members without any intervention of the Court is called 'voluntary winding up'. In voluntary winding up, the company and its creditors are left to settle their affairs without going to the CLB for directions or orders if and when necessary. Winding up should not be confused with insolvency. Company may be solvent and running a prosperous business yet it may decide to be wound up voluntarily, e.g., in pursuance of a scheme of reconstruction or amalgamation.

A company may be wound up voluntarily: (1) if the company in general meeting passes an ordinary resolution for voluntary winding up where the period fixed by the Articles for the duration of the company has expired or the event has occurred on which under the Articles the company is to be dissolved; (2) if the company resolves by special resolution that it shall be wound up voluntarily (Section 484).

When a company has passed a resolution for voluntary winding up, it must within 14 days of the passing of the resolution, give notice of the resolution by advertisement in Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated. In case of default, the company and every officer of the company who is in default shall be punishable with fine which may extend upto ₹500 for every day during which the default continues (Section 485).

Consequences of voluntary winding up. The consequences of voluntary winding up are as follows:

1. A voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed (Section 486). This will be so even when after passing a resolution for voluntary winding up, a petition is presented for winding up by the Court (Section 441).

2. The company, from the commencement of winding up, must cease to carry on its business except so far as may be required to secure a beneficial winding up although the corporate state and powers of the company continue until final dissolution (Section 487).

3. All transfer of shares and alterations in the status of members, made after the commencement, are void unless sanctioned by the liquidator (Section 536).

4. A resolution to wind up voluntarily operates as notice of discharge to the employees of the company (Fowler v. Commercial Times Co.) except: (a) when the liquidation is only with a view to 'reconstruction' [Midland Counties Bank Ltd. v. Attwood (1905) 1 Cg. 357] or (b) when business is continued by the liquidator for the beneficial winding up of the company.

5. On the appointment of the liquidator, all the powers of the Board of Directors, managing director or 'manager' shall cease except (Section 491):

   (a) for the purpose of giving notice to the Registrar about the name of the liquidator appointed, or

   (b) insofar as the company in general meeting or the liquidator may sanction the continuance of their powers.

10.2.3 Types of Voluntary Winding Up

Voluntary winding up may be of three types: (a) Members' Voluntary winding up; (b) Creditors' Voluntary winding up; (c) Voluntary winding up under supervision of the Court.

10.2.4 Members' Voluntary Winding Up

Members' Voluntary winding up is possible only when the company is solvent and is able to pay its liabilities in full. Following are the important provisions regarding members' voluntary winding up.

1. Declaration of solvency (Section 488). Where it is proposed to wind up a company voluntarily, its directors, or in case the company has more than two directors, the majority of the directors, may at a meeting of the Board, make a declaration verified by an affidavit, to the effect that they have made a full enquiry into the affairs of the company and that having done so, they have formed the opinion that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding 3 years from the commencement of the winding up as may be specified in the declaration. In order to be effective, this declaration must be:

   (i) made within five weeks immediately preceding the date of passing of the winding up resolution by the members;

   (ii) delivered to the Registrar for filing before the said date;

   (iii) accompanied by a copy of the report of the auditors of the company on the profit and loss account prepared since the date of the last account and the balance-sheet of the company made out as on the last mentioned date and also embodies a statement of the company's assets and liabilities as at that date.

   Any director of a company making a declaration under this section without having reasonable grounds for the opinion that the company will be able to pay its debts in full within the period specified in the declaration, shall be punishable with imprisonment for a term which may extend to six-months, or with fine upto ₹5,000 or with both. If the company is wound up in pursuance of a resolution passed within the period of five weeks after making the declaration, but its debts

are not paid or provided for in full within the period specified in the declaration, it shall be presumed, until the contrary is shown, that the director did not have reasonable grounds for his opinion.

If the above provisions are not complied with, the winding up shall not be a members' voluntary winding up [Vosica vs. Janda Rubber Works AIR (1950) East Punjab 180] and in such case provisions (Sections 490 and 498) relating to members voluntary winding up cannot apply and if liquidator is appointed in pursuance of Section 490 or 498 such appointment would be bad in law. In such a case the provisions relating to creditor's voluntary winding up (Sections 500-509) should be followed and the violation of these provisions will make the winding up proceedings void ab initio (M. Kakshmiah v. Registrar of Companies, Trivandrum unreported case decided by the Kerala High Court) and if default is made in calling a meeting of the creditors then the company and the directors as the case may be, shall be punishable with fine which may extend to ₹10,000 and in case of default by the company, every officer of the company who is in default, shall be liable to the like punishment [Section 500 (6)]. The court may, if moved by the company or its shareholders, instead of treating the winding up proceedings as invalid, direct the company to convene the creditors meeting [Light of Asia Insurance Company, I L.R. 1940 (2) Cal.325]. The above rules will be applicable even where a declaration of solvency has been filed but in accordance with the provisions of Section 488(2).

The company, however, may pass a fresh resolution for its winding up the after and complying with the requirements of Section 488 (Declaration of Solvency).

2. Appointment and remuneration of liquidators (Section 490). The company in general meeting must: (a) appoint one or more liquidators for the purpose of winding up the affairs and distributing the assets of the company; and (b) fix the remuneration, if any, to be paid to be liquidator or liquidators.

   Any remuneration so fixed cannot be increased in any circumstances whatever, whether with or without the sanction of the court. No liquidator shall take charge of his office unless his remuneration is fixed. Further, if a vacancy occurs by death, resignation or otherwise in the office of the liquidator appointed by the company, the company in general meeting may, subject to any arrangement with its creditors, fill the vacancy. For this purpose a meeting may be convened by any contributory or the continuing liquidator or by the court on the application of any of them (Section 492).

3. Board's power to cease. On the appointment of a liquidator, all the powers of the Board of Directors and of the Managing or wholetime directors or manager shall cease except for purpose of giving a notice of such appointment to the Registrar. But their powers may continue if sanctioned by the general body or by the liquidator so far as the sanction applies (Section 491).

4. Notice of appointment of liquidator to be given to registrar (Section 493) The company must give notice to the Registrar regarding the appointment of liquidator within 10 days of his appointment. In case of default, the company and every officer of the company (including liquidator) who is in default shall be punishable with fine which may extend to ₹1,000 for everyday during which the default continues.

5. Power of liquidator to accept shares, etc., as consideration of sale of property of the company (Section 497). The liquidator may accept shares, policies or like interests in consideration of the sale of the company's undertaking to another company, with an objective to distribute them amongst the members of transferor company, provided: (a) a special resolution is passed by the company to that

effect; and (b) he purchases the interest of any dissenting member at a price to be determined by agreement or by arbitration.

The money to the dissenting members should be paid before the company is dissolved and should be raised in such manner as may be determined by special resolution.

6. Duty of liquidator to call creditor's meeting in case of insolvency (Section 495). If the liquidator is at any time of opinion that the company will not be able to pay its debts in full within the period stated in the declaration of solvency, or that period has expired without the debts having been paid in full, he must forthwith summon a meeting of the creditors and must lay before the meeting a statement of the assets and liabilities of the company. If he fails to comply with the above requirements, he shall be punishable with fine which may extend to ₹5,000.

7. Duty of the liquidator to call general meeting at the end of each year (Section 496). In case winding up continues for more than one year the liquidator must: (a) call a general meeting of the company at the end of the first year from the commencement of winding up and at the end of each succeeding year, or as soon thereafter as may be convenient within 3 months from the end of the year or such longer period as the Central Government may allow; and (b) lay before the meeting an account of his acts and dealing and of the conduct of the winding up during the preceding year.

8. Final meeting and dissolution [Section 497]. As soon as the affairs of the company are fully wound up, the liquidator must: (a) make up an account of the winding up showing how the winding up has been conducted and the property of the company has been disposed of; and (b) call a general meeting of the company for the purpose of laying the account before it, and giving any explanation thereof.

   The meeting must be called by advertisement specifying the time, place and object of the meeting and must be published atleast one month before the meeting in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated.

   Within one week after the meeting, the liquidator must send to the Registrar and the Official Liquidator each, a copy of the account and the return regarding holding of the meeting. In case quorum was not present at the meeting called, he must report accordingly.

   On receipt of the above documents, the Registrar will register them and the official liquidator shall make a scrutiny of the books and papers of the company and report to the CLB, the result of his scrutiny. If the report of the Official Liquidator shows that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest, then, from the date of submission of report of the CLB, the company shall be deemed to be dissolved. In the case of an unfavourable report, the CLB shall direct the Official Liquidator to make a further investigation of the affairs of the company. On receipt of the report of the Official Liquidator on such further investigation, the CLB may either make an order that the company stands dissolved with effect from the date specified in the order or make such order as the circumstances of the case brought out in the report permit.

10.2.5 Creditors' Voluntary Winding Up

The procedure in a creditors' voluntary winding up is based upon the assumption that the company is insolvent. From the beginning, meetings of creditors are held in addition to those of the members. The chief power to appoint the liquidator is in the

hands of the creditors and there is provision for the appointment of a committee of inspection, if desired, to which is left the fixing of the liquidator's remuneration. The detailed provisions as enlisted in Sections 500 to 509 are given below:

Meeting of Creditors (Section 500). When no statutory declaration of solvency has been made and filed as required by the Act, the Board of Directors, acting on behalf of the company must summon a meeting of the creditors, for the same day or the next day after the meeting at which the resolution for voluntary winding up is to be proposed. The notice for the meeting has to be sent by post to the creditors simultaneously with the sending of the notices of the meeting of the company. Notice of the meeting should also be advertised in the Official Gazette and in two newspapers circulating in the district of the registered office or principal place of business of the company

The Board of Directors must prepare and lay before the meeting a statement of the position of the company's affairs, together with a list of its creditors and the estimated amounts of their claims. Violation of Section 500 is punishable with fine which may extend to ₹10,000.

Notice to registrar. A copy of any resolution passed at the creditors' meeting must be filed with the Registrar within 10 days of the passing thereof. If default is made then the company and every guilty officer shall be punishable with fine which may extend to ₹500 for every day of the default (Section 501).

Appointment of liquidator (Section 502). The creditors and the members at their respective first meetings may nominate a person to be liquidator for the purpose of winding up the affairs and distributing the assets of the company. If the creditor and the members nominate different persons, the creditor's nominee will as a rule by the liquidator.

But any director, member or creditor may apply to the court for an order that the company's nominee or the Official Liquidator or some other person should be appointed. If no person is nominated by the creditors, the members' nominee shall be the liquidator. Vacancies in the office caused by death, resignation or otherwise may be filled by creditors, except where the liquidator was originally appointed by or by the direction of the court, when the court will on application fill the vacancy.

Committee of inspection (Section 503). The creditors at their first or any subsequent meeting may, if they think fit, appoint a committee of inspection of not more than five members. If such committee is appointed, the company may, either at the meeting at which the winding up resolution is passed, or at a later meeting, appoint five persons to serve on the committee. If the creditors object against the persons appointed by the company, then the matter will be referred to the court for the final decision. The powers of such committee are the same, as those of a Committee of Inspection appointed in a compulsory winding up.

Fixing of liquidator's remuneration (Section 504). The remuneration to be paid to the liquidator or liquidators has to be fixed by the committee of inspection or if there is no such committee, by the creditors. Where the remuneration is not so fixed, it must be determined by the court. Any remuneration once fixed shall not be increased in any circumstances, whatever, whether with or without sanction of the court

Board's powers to cease on appointment of liquidator (Section 505). On the appointment of liquidator, all the powers of the Board of Directors shall cease, except in so far as the committee of inspection, or if there is not such committee, the creditors in general meeting, may sanction the continuance thereof.

Duty of liquidator to call meeting of company and of creditors at the end of each year (Section 508). In the event of the winding up continuing for more than one year,

the liquidator must call a general meeting of the company and a meeting of the creditors at the end of the first year, from the commencement of the winding up and at the end of each succeeding year, or as soon thereafter as may be convenient within 3 months from the end of the year or such longer period as the Central Government may allow. Further, he may lay before the meeting an account of his acts and dealings and of the conduct of winding up during the preceding year, together with a statement in the prescribed form and containing the prescribed particulars with respect to the proceedings and position of the winding up.

Final meeting and dissolution (Section 509). As soon as the affairs of the company are fully wound up, the liquidator must: (a) make up an account of the winding up, showing how the winding up has been conducted and the property of the company has been disposed of; and (b) call a general meeting of the company and a meeting of the creditors for the purpose of laying the account before the meeting and giving any explanation thereof.

Each such meeting must be called by advertisement and must specify the time, place and objects thereof and must be published atleast one month before the meeting in the Official Gazette and also in some newspaper circulating in the district where the registered office of the company is situated.

Within one week after the date of the meetings, the liquidator shall send to the Registrar and the Official Liquidator a copy of the account and a return of the meeting held [Section 509 (3)].

The Official Liquidator, after scrutiny of the books and papers of the company, shall make a report to the court. If this report states that the affairs of the company have not been conducted in a manner prejudicial to the interest of the company or public then from the date of the submission of the report the company shall be deemed to be dissolved; otherwise the court will ask Official Liquidator to make further investigation and may, after that report, order that the company shall stand dissolved from the specified date [Section 509 (6)].

10.2.6 Distinction between Members' Voluntary Winding Up and Creditor's Voluntary Winding Up

1. Members' voluntary winding up can be resorted to by solvent companies and thus requires the filing of a 'declaration of solvency' by the directors of the company with the Registrar: Creditors' winding up, on the other hand, is resorted to by insolvent companies.
2. In members' voluntary winding up there is no need to have creditor's meeting. But in the case of creditors' voluntary winding up, a meeting of the creditors must be called immediately after the meeting of the members.
3. Liquidator, in the case of members' windiog up is appointed by the members. But in the case of creditors' voluntary winding up, if the members and creditors nominate two different persons as liquidators, creditors' nominee shall become the liquidator.
4. In the case of creditor's voluntary winding up, if the creditors so wish a 'Committee of Inspection' may be appointed. In the case of members' voluntary winding up, there is no provision for any such committee.

10.2.7 Voluntary Winding Up under Supervision of the Court

At any time after a company has passed a resolution for voluntary winding-up, the Court may make an order that the voluntary winding-up should continue subject to the

supervision of the Court (Section 522). Application for such supervision order may be made either by a creditor, a contributory, the company or the liquidator.

One advantage of having a supervision order is that the liquidator is allowed to occupy the same position and exercise the same power (subject to restrictions where necessary) as voluntary liquidator. At the same time the advantage of a compulsory winding-up as regards stay of suits and other proceedings and making and enforcing calls, etc., are also secured and the Court is empowered to exercise all the powers which it can exercise in a compulsory winding-up. In truth, a supervision order is an amalgam of both — a voluntary winding-up and a winding-up by Court as it is made on such terms and conditions as the Court thinks just.

Such an order is passed by the court under the following circumstances:

1. the resolution for winding-up was obtained by fraud, or
2. the rules relating to winding-up order are not being observed, or
3. the liquidator is prejudicial or is negligent in collecting the assets.

The Court in such a case gets the same powers as it has in the case of compulsory winding up. The Court may also appoint an additional liquidator or liquidators. It may also remove any liquidator and fill any vacancy occasioned by the removal or by death or by resignation (Section 524). A liquidator so appointed shall have the same powers, be subject to the same obligations and in all respects stand in the same position as if he had been appointed in accordance with the provisions of the Act relating to the appointment of liquidator in voluntary winding-up, subject, however, to any restrictions the Court may impose (Section 525).

Unless the Court imposes restrictions on the exercise of any powers by the liquidator, he will have all the powers conferred on a liquidator in voluntary winding up [Section 526(1)]. The Court will have as wide powers as in compulsory winding-up. The Court may stay suits or legal proceedings. It can make or enforce calls and all other orders necessary for beneficial winding-up of the company [Section 526(2)].

Powers of Court to Order Compulsory Winding-up (Section 527). The court may pass an order for compulsory winding-up superseding the order of winding-up under its supervision. The Court may then appoint a person who is the liquidator, either provisionally or permanently to be liquidator in winding-up by the court in addition to, and subject to the control of Official Liquidator.

Dissolution of Company. In the case of winding-up under the supervision of the Court, the company is deemed to be dissolved from the date the order of the court is issued to that effect. The Court will issue such an order when the affairs of the company have been completely wound-up and the liquidator has made an application to the Court requesting it to order for the dissolution of the company.

Where a company has been dissolved according to the due process of law, (except under Section 560-defunct companies) on the expiry of 5 years from the date of dissolution of the company, the name of the company should be struck off the Register of companies after noting against its name that it has been dissolved.

10.3 LIQUIDATORS

The commencement of winding up of a company does not put an end to the existence of the company. Its assets are to be realised and distributed among the debenture holders, creditors, shareholders, etc. For the purpose, somebody has to act as an agent of the company. Such agent is called liquidator. For the purpose of filing Income Tax

Return for the income earned during the winding up it has been held that the liquidator will be regarded as principal officer of the company (*Mysore Spun Silk Mills Ltd.*).

Rules relating to their appointment, rights, powers and duties can be discussed under the following heads: 1. In compulsory winding up. 2. In voluntary winding up.

10.3.1 Liquidators in Compulsory Winding Up

Appointment of official liquidator. On a winding up order being made in respect of company, the official liquidator, by virtue of his office becomes the liquidator of the company (Section 449). Section 448 provides that the official liquidator (i) may be appointed from a panel of professional firms of chartered accountants, advocates, company secretaries, cost and works accountants or firms having a combination of these professions, which the Central Government shall constitute for the Court; or (ii) may be a body corporate consisting of such professionals as may be approved by the Central Government from time to time; or (iii) may be a whole time or a part-time officer approved by the Central Government. However, before appointing the official liquidator, the Court may give due regard to the views or opinion of the secured creditors and workmen.

Provisional liquidator. After presentation of the petition but before the hearing, application may be made to the Court by the company or creditors or contributories to appoint a provisional liquidator to safeguard the assets pending the hearing. The powers of a provisional liquidator are the same as those of a liquidator unless limited by the Court. As soon as winding up order is made, the provisional liquidator becomes the liquidator of the company (Section 450).

10.3.2 Committee of Inspection to Act with Liquidator

The content for this point has been mentioned in Creditors' Voluntary Winding Up (10.2.5). Please refer to the section provided above.

10.3.3 Liquidators in voluntary winding up

(I) In Member's Voluntary Winding up the following points have already been explained: (a) Appointment and Remuneration; (b) Notice of his appointment to Registrar; (c) Duty to call creditors' meeting in case of insolvency; (d) Duty to call general meeting every year; (e) Duty to call final meeting.

(II) In Creditors' Voluntary Winding up the following points have already been explained: (a) Appointment; (b) Remuneration: (c) Duty to call meeting of the creditors at the end of each year; (d) Duty to call final meeting.

Common points as regards liquidators in voluntary winding up;

Restriction on appointment. A body corporate cannot be appointed as a voluntary liquidator and any such appointment would be void. If a body corporate acts as a liquidator, that body corporate, its director or manager shall be punishable with fine upto ₹10,000 (Section 513).

Further, any person who gives or agrees to give or offers to any member or creditor of a company any gratification whatever with a view to: (a) securing his own appointment or nomination as the company's liquidator, (b) securing or preventing the appointment or nomination of some person other than himself, as a liquidator of the company, shall be punishable with fine upto ₹1,000 (Section 514).

Power of Court to appoint and remove a liquidator (Section 515). (1) If for any cause whatever, there is no liquidator acting, the Court may appoint the official liquidator or any other person as liquidators. (2) The Court may, on cause shown, remove a liquidator and appoint an Official Liquidator or any other person as a liquidator in

place of the removed liquidator. (3) The Court may also appoint or remove a liquidator on the application made by the Registrar in this behalf. (4) If the Official Liquidator is appointed as liquidator, the remuneration to be paid to him shall be fixed by the Court and shall be credited to the Central Government.

Notice by liquidator (Section 516). Within 30 days after his appointment, the liquidator must publish in the official gazette and deliver to the Registrar a notice of his appointment in the prescribed form, otherwise a punishment of ₹500 for every day of default shall be attracted.

10.4 DISSOLUTION OF COMPANIES

A company is said to be dissolved when it ceases to exist as a corporate entity for all practical purposes but it is not the extinction of the company. The company is kept, after dissolution, in 'suspended animation' for 2 years. The dissolution of a company may be declared void by the Court, under Section 559, within a period of two years from the date of dissolution. Thus, within a period of 2 years from the date of dissolution, the company can be revived by the Court by declaring the dissolution void. The Court will do so at the application by the liquidator of the company or by any other person who appears to the Court to be interested in this [Section 559 (1)]. It will be the duty of the applicant to file a copy of the above order of the Court, with the Registrar, within 30 days after the making of the order [Section 559(2)].

Modes of Dissolution. Dissolution of a company may be brought about in any of the following three ways:

(1) In case of defunct companies – By removal of its name from the Register of Companies (Section 560). If the Registrar has reason to believe that a company is not carrying on business, he is empowered to adopt the procedure prescribed by Section 560 and strike out the company's name from the register as being 'defunct'. This may be done whether the company is a going concern or in liquidation.

(2) In pursuance of amalgamation or reconstruction. By order of the court without winding up, i.e., where a reconstruction or amalgamation is being carried under Section 394(b)(iv).

(3) In pursuance of the winding up of the company.

Dissolution of defunct companies (Section 560). A defunct company means a company which has never commenced business or which is not carrying on business. Section 560 lays down the procedure for the dissolution of defunct companies, without resorting to the winding up machinery. The procedure is as follows:

1. Where the Registrar has reasonable cause to believe that a company is not carrying on business or is not in operation, he shall send to the company by post a letter inquiring whether the company is carrying on business or is in operation.

2. If the Registrar does not within one month of sending the letter receive any answer thereto, he shall, within 14 days after expiry of the month, send to the company by post a registered letter referring to the first letter and stating that no answer thereto has been received and that, if an answer is not received to the second letter within one month from the date thereof, a notice will be published in the Official Gazette, with a view of striking the name of the company off the Register.

3. If the Registrar either receives an answer from the company to the effect that it is not carrying on business or is not in operation, or does not within one month after sending the second letter receive any answer, he may publish in the Official Gazette and send to the company by registered post a notice that, at the expiration

of 3 months from the date of that notice, the name of the company, unless cause is shown the contrary, be struck off the register and the company will be dissolved.

The dissolution of the company in the above stated manner, shall not, however, affect: (a) the liability, if any, of every director, manager or other officer who was exercising any power of management and of every member of the company. In other words, such persons shall be liable as if the company had not been dissolved; and (b) the power of the court to wind up a company.

Restoration of the name of the company. If a company or any member or any creditor feels aggrieved by the removal of the company's name from the Register of companies, the Court may, on an application by the aggrieved party, any time within 20 years from the publication in the Official Gazette of the notice of striking off the name of the company, order that the name of the company should be restored in the Register. Power of the Court to order for restoration of company's name is discretionary and will be given when the Court is satisfied that: (1) after restoration, the company will be in a position to carry on its business; or (2) at the time of striking off, the company was carrying on business or was in operation; or (3) it is just and equitable that the company's name be restored.

The Court may also, on passing such an order, give such directions and make such provisions as seem just for placing the company and all other persons in the same position, as nearly as may be, as if the name of the company had not been struck off.

A certified copy of the Court's order must be delivered to the Registrar and upon such delivery the company shall be deemed to have continued in existence as if its name had not been struck off.

Dissolution in pursuance of amalgamation [Section 394(1)]. The Court may, either by the order sanctioning the compromise or arrangement or by a subsequent order, make provision for the dissolution, without winding up, of the company whose undertaking, property or liabilities, either wholly or in part, under the scheme of amalgamation or construction, is transferred to another company.

But no such order shall be made by the Court unless the official liquidators has, on scrutiny of the books and papers of the company, made report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest. The Court can, however, within 2 years declare the dissolution void (already explained).

Dissolution in pursuance of winding up. The corporate existence of a company continues through winding up till it is dissolved. It may be dissolved as follows:

(A) In case of compulsory winding up (Section 481). The Court will make an order dissolving a company if: (i) the affairs of the company have been completely wound up (i.e., assets collected and liabilities paid as far as practicable); or (ii) the liquidator cannot proceed with the winding up for want of funds and assets or for any other reasons whatever: or (iii) it is just and reasonable in the circumstance of the case that an order of dissolution of the company should be made.

On making of the order of the dissolution, the company shall be dissolved from the date of the order [Section 48 (1)]. The official liquidator shall file a copy of the order of dissolution within 30 days of making of the order (Section 497).

(B) In case of members' voluntary winding up (Section 497). As soon as the Official Liquidator, after scrutinizing the books, accounts and papers of the company, makes a report to the Court that the affairs of the company have not been conducted in a manner prejudicial to the interest of its members or to public interest, then from the date of the submission of the report to the court, the company shall be deemed to be

dissolved. Where the liquidator reports that the affairs have not been so conducted, the CLB shall direct him to make further investigation and submit his second report to the Court and may order that the company shall stand dissolved from a date specified in that order [Section 497(b)].

(C) In case of creditors voluntary winding up (Section 509). Same as above [Section 509(6)]. The Court can, however, declare the dissolution void within 2 years.

When a company has been dissolved according to the due process of law, except when such dissolution is under Section 560, on the expiry of 5 years from the date of dissolution of the company, the name of the company should be struck off the Register of Companies after noting against its name that it has been dissolved. Thus in case of defunct companies, dissolution and extinction takes place at the same time but in other cases extinction follows 5 years after.

Check Your Progress

Fill in the blanks:

1. If the number of members is reduced below the statutory minimum of _____ in a public company or 2 in a private company, the company may be ordered to be wound up.
2. Winding up by the creditors or members without any intervention of the Court is called ____ _____
3. Voluntary winding up may be of three types: (a)_____ _____; (b) Creditors' Voluntary winding up; (c)_____.
4. The _____and the members at their respective first meetings may nominate a person to be liquidator for the purpose of winding up the affairs and distributing the assets of the company.
5. On a winding up order being made in respect of company, the_____, by virtue of his office becomes the liquidator of the company

10.5 LET US SUM UP

- The winding up or liquidation of a company is the process whereby its life is ended and its property administrated for the benefit of its creditors and members.
- A company may be wound up in any of the three ways, (i) compulsory winding up under an order of the court; (ii) voluntary winding up, and (iii) voluntary winding up subject to the supervision of the Court.
- The winding up of a company by the Court shall be deemed to commence at the time of the presentation of the petition for winding up.
- When a winding up order is made by the Court, the directors of the company must make to the liquid for a statement as to the affairs of the company under section 454.
- The Court may, at the time of making an order of winding up of a company or at any time thereafter, direct that there shall be appointed a committee of inspection to Act with the liquidator. Winding up by the creditors or members without any intervention by the Court is called 'voluntary winding up'.
- A company may be wound up voluntary: (i) if the company in general meeting passes an ordinary resolution for voluntary winding up where the period fixed by the articles for the duration of the company has expired or the event has occurred

on which, under the articles, the company is to be dissolved. (ii) if the company resolves by special resolution that it shall be wound up voluntarily.

- A voluntary winding up is deemed to commence at the time when the resolution for voluntary winding up is passed.
- Voluntary winding up may be: (i) Members' voluntary winding up or (ii) Creditors' voluntary winding up.
- The members' voluntary winding up is possible only when the company is solvent and is able to pay its liabilities is full. The Board of Directors has to prepare a declaration of solvency.
- Where no declaration of solvency is made, then the voluntary winding up will be creditors voluntary winding up upon the assumption that the company is not solvent.
- At any time after a company has passed a resolution for voluntary winding up, the court may make an order that the voluntary winding up should continue subject to the supervision of the Court.
- Application for such supervision order may be made either by a creditor' a contributory, the company, or the liquidator. After the winding up procedure is completed, the company is dissolved.
- A company is said to be dissolved when it ceases to exist as a corporate body. However, the dissolution of a company may be declared void by the Court within two years from the date of dissolution.

10.6 LESSON END ACTIVITY

Study the 'Preferential Payments' as envisaged in the Companies Act, 1956. Would you like that the order of payment given therein be changed? If so, why?

10.7 KEYWORDS

Contributory: It means any person who is liable to contribute to the assets of a company in the event of its being would up.

Voluntary winding up: A winding up either by the creditors or by the members without any intervention of the court is called voluntary winding up.

Compulsory winding up: Compulsory winding up refers to the process by which a company (or part of a company) is brought to an end and the assets and property are redistributed.

Declaration of solvency: It is a declaration by the directors of a company that the company has no debts, or that it will be able to pay its debts in full within such period not exceeding three years from the commencement of the winding up.

Voluntary winding up subject to the supervision of the Courts: When, at any time after a company has passed a resolution for voluntary winding up, a Court makes an order that the voluntary winding up shall continue subject to its supervision, then it is known as voluntary winding up subject to the supervision in the Court.

Dissolution: A company is said to be dissolved when it ceases to exist as a corporate body for all practical purposes.

10.8 QUESTIONS FOR DISCUSSION

1. What is winding up? Discuss the circumstances in which a company may be wound up by the Company Law Board
2. What is the effect of a winding up order passed by the Company Law Board?
3. Define the term 'contributory'. Discuss the liability of members of a company in the event of its being wound up.
4. Explain the procedure to wind up a company voluntarily.
5. What is a defunct company? What procedure is followed to dissolve it?
6. What is the difference between winding up and dissolution?

Check Your Progress: Model Answer

1. Seven, Two
2. Voluntary winding up
3. Members' Voluntary winding up, Voluntary winding up under supervision of the Court
4. Creditors
5. Official liquidator

10.9 SUGGESTED READINGS

S.S Gulshan, *Business Law*, Third Edition, 2006, Excel Books, New Delhi

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